



SEEK WISDOM, ELEVATE YOUR INTELLECT AND SERVE HUMANITY!



**CHALLENGES AND PROSPECTS OF INTEREST-FREE BANKING SERVICES IN ETHIOPIA:
THE CASE OF HIJRA BANK**

BY

AMINA ABDELLA AHMED

GSE/7676/14

ADDIS ABABA, ETHIOPIA

JUNE, 2025



SEEK WISDOM, ELEVATE YOUR INTELLECT AND SERVE HUMANITY!



**Challenges and Prospects of Interest-Free Banking Services in
Ethiopia: The Case of Hijra Bank**

BY

Amina Abdella Ahmed

Advisor

Kelifa Srmolo (Phd)

**Thesis Submitted to Addis Ababa University College of Business
and Economic in Partial Fulfillment for the requirement of Masters
of Science Degree in Accounting and Finance.**

Addis Ababa, Ethiopia

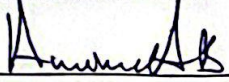
June, 2025

DECLARATION

I, Amina Abdella Ahmed hereby declare that this thesis entitled Challenges and Prospects of Interest-Free Banking Services in Ethiopia: The Case of Hijra Bank, and the work presented in it, are my own original work. I confirm that:

- ❖ This research was conducted wholly or mainly during my candidature for a Master's Degree at Addis Ababa University.
- ❖ This thesis has not been submitted, either partially or fully, by any other person for the award of a degree at any other university or institution.
- ❖ All sources of information used in this thesis are properly cited, and any direct quotations are clearly referenced. Apart from such quotations, this thesis is entirely my own work.

Name: Amina Abdella Ahmed

Signature: 

Date: June 18, 25

APPROVAL SHEET

We, the Examining Board, hereby approve that this thesis has successfully passed the defence and review process.

**Challenges & Prospects of Interest-Free Banking Services in Ethiopia:
The Case of Hijra Bank**

By
Amina Abdella

Approved by Board of Examiners

Name & Title	Signature	Date
Chairperson	Kelita SMO	18/6/2025
Advisor		June 18, 2025
External Examiner	Tenkirsatu	
Internal Examiner	Abelaw Kerre	18/06/25

ACKNOWLEDGMENTS

First and foremost, I express my profound gratitude to Allah for granting me health, strength, and fortitude to successfully navigate through this journey.

I extend my heartfelt thanks to my advisor, [Advisor's Name], for his invaluable guidance, insightful perspectives, and unwavering support from the inception of the research proposal to the completion of this study. His mentorship has been instrumental in shaping this work.

I am also deeply grateful to the employees and customers of Hijra Bank for generously providing the necessary information and insights essential for this research. Their cooperation greatly enhanced the credibility and depth of the study's data sources.

Finally, I sincerely appreciate all those who supported and contributed to this study, whether mentioned by name or not. Your encouragement and assistance were indispensable, and I remain truly indebted to each one of you.

Table of Contents

DECLARATION	Error! Bookmark not defined.
APPROVAL SHEET	Error! Bookmark not defined.
ACKNOWLEDGMENTS.....	iii
<i>ABSTRACT</i>	vii
CHAPTER ONE	1
1. INTRODUCTION.....	1
1.1. Background of the study	1
1.2. Statement of the problem	3
1.3. Research question	4
1.4. Objectives of the study.....	5
1.4.1. General objective	5
1.4.2. Specific objective.....	5
1.5. Significance of the study.....	5
1.6. Scope of the study	6
1.7. Limitations of the study	6
1.8. Organization of the paper.....	7
2.1. Introduction.....	8
2.2. History of Islamic banking in Ethiopia	8
2.3. Definition of an Islamic Bank.....	11
2.4. About Hijra bank.....	12
2.5. Principles of an Islamic financial system.....	12
2.5.1. Prohibition of interest Riba in Islam	13
2.5.2. Profits and Loss Sharing (PLS).....	14
2.5.3. Prohibition of Activities with Elements of Gharar (Uncertainty)	14
2.5.4. Prohibition of Maisir (Gambling Activites).....	15
2.5.5. Prohibition of the production and sale of goods and services that is prohibited in Islam.....	15

2.5.6.	Zakah.....	16
2.6.	Islamic Banks' Uses of Funds or Islamic Banks Modes of Finance.....	16
2.6.1.	Mudarabah (Trust Finance).....	18
2.6.2.	Musharakah (Joint Venture, sharing of loss and profit).....	19
2.6.3.	Murabahah (cost plus profit markup).....	20
2.6.4.	Bai-salam (advance purchase or sales contract) or postponed delivery	20
2.6.5.	Istisna (commissioned manufactured).....	21
2.6.6.	Ijarah (Lease)	21
2.6.7.	Ijarah thumma al bai' (hire purchase)	22
2.6.8.	Musawamah	22
2.6.9.	Wakallah	23
2.6.10.	Kafalah	23
2.6.11.	Qardh Hasan (benevolent or interest-free loan).....	23
2.7.	Empirical Review.....	24
CHAPTER THREE		30
3.	RESEARCH METHODOLOGY.....	30
3.1.	Introduction.....	30
3.2.	Research Approach	30
3.3.	Research Design.....	31
3.4.	Research Methodology	32
3.5.	Population, Sampling Techniques and Sample Size	32
3.5.1.	Target population	32
3.5.2.	Sampling techniques	33
3.5.3.	Sampling Size Determination	33
3.6.	Data Collection Techniques and Procedures.....	34
3.6.1.	Data source.....	34
3.4.4.2	Data collection instruments.....	34
3.7.	Data Analysis Techniques.....	35
3.8.	Ethical Consideration.....	35
CHAPTER FOUR.....		36
4.	DATA PRESENTATION, ANALYSIS AND INTERPRETATION.....	36
4.1.	Introduction.....	36

4.2.	Response Rate of Respondents	37
4.3.	Demographic Information of Respondents	38
4.3.1.	Gender	38
4.3.2.	Educational Level	38
4.3.3.	Occupation	38
4.3.4.	Duration of Using Islamic Banking	39
4.3.5.	Duration of Working at Hijra Bank	39
4.4.	Prospects of Interest-Free Banking Services in Ethiopia.....	40
4.5.	Potential Impacts of Full-Fledged Islamic Banking.....	42
4.6.	Financial Inclusion Through Islamic Banking in Ethiopia	44
4.7.	Customer Perceptions and Attitudes towards Islamic Banking	46
4.8.	Challenges Facing the Growth of Islamic Banking in Hijera Bank.....	47
4.9.	Regulatory and cultural impact on Islamic Banking Development	49
4.10.	Human Resource Capacity in Ethiopian Islamic Banking.....	51
4.11.	Market Dynamics and Competition	53
4.12.	Interview Result Analysis	55
4.13.	Secondary Data Analysis Hijra Bank Banking Development and Performance.....	56
4.13.1.	The performance of the IFB in Hijra Bank	56
CHAPTER FIVE		67
5.	SUMMARY, CONCLUSION, AND RECOMMENDATIONS	67
5.1.	Summary of the Study.....	67
5.2.	Conclusion	69
5.3.	Recommendations.....	70
5.4.	Suggestions for Future Study	71
	Questionnaire	78

ABSTRACT

This study explores the challenges and prospects of interest-free banking services in Ethiopia, with a particular focus on Hijra Bank. Adopting a qualitative approach complemented by descriptive research design and mixed methods, data were collected from 384 respondents, including both bank employees and customers. The research utilized primary and secondary sources to examine the operational, regulatory, and financial dimensions of Islamic banking in the Hijra Bank. Findings reveal increasing public acceptance of Islamic banking, primarily driven by the growing demand for Sharia-compliant financial products and the sector's potential to foster financial inclusion. However, the study identified several systemic challenges, including underdeveloped regulatory frameworks, limited skilled human capital, inadequate technological integration, and widespread public misunderstanding of Islamic finance principles. Secondary data analysis from 2022 to 2024 highlighted substantial growth for Hijra Bank across key performance indicators total assets, interest-free deposits, customer base, and profitability. The bank's transition from net losses in 2022 to a net profit by 2024 reflects improved operational efficiency, strong public trust, and the rising viability of Islamic banking in Ethiopia. Despite early operational hurdles, the study concludes that the outlook for interest-free banking in Hijra Bank is optimistic. Realizing this potential will require concerted efforts in regulatory reform, workforce capacity building, digital transformation, financial product innovation, and enhanced public awareness. Strategic collaboration among policymakers, financial institutions, and community stakeholders is essential to foster sustainable growth and competitiveness in Ethiopia's Islamic banking sector.

Key words: *Islamic banking, interest-free banking, Hijra Bank, Ethiopia*

CHAPTER ONE

1. INTRODUCTION

1.1. Background of the study

According to Ahmed (2012), Interest-free banking has surfaced as one of the most fleetly expanding sectors in the global fiscal system, it surfaced as an indispensable fiscal system that's in line with the values and character of Islam and it's governed by the principles of sharia law it requires avoiding any unethical practices in achieving its pretensions and objects. Indeed, western principles and laws have dominated all corridor of the world. IFB is part of the Islamic reanimation of Islamic principles. In Islamic financial law, there are some methods of financing such as Musharaka, Murabaha, Mudarab, and Ijarah which provide all the contractual details of the business, and some contracts are based on profit and loss-sharing schemes.

The development process of the IFB system has passed a lot of obstacles before reaching moment's status, substantially owing to the dominance of the conventional fiscal assiduity that holds opposing values to the Islamic profitable system (Alyu 2016).

Also, Full- fledged interest free Islamic banking in Ethiopia is a veritably new practice. The nation's first interest-free banking directive by the National Bank of Ethiopia was approved in 2008, but its implementation was short-lived. A 2011 "Directives to Authorize the Business of Interest-free Banking No. SBB/51/2011" by the NBE further impeded the establishment of full-fledged interest free Islamic banks. However, a 2019 proclamation paved the way for their operation, with the first two officially commencing in 2021.

However, the adoption of Islamic finance in Ethiopia offers opportunities for financial inclusion and fueling economic growth by mobilizing domestic saving and supporting productive investments through IFB financing and by diversifying the financial ecosystem leading to more innovative products, lower costs, bettering service for all Ethiopian. However, it also presents challenges such as establishing a legal framework, building a skilled workforce, fostering

innovation, bridging awareness gaps, and ensuring liquidity. By addressing these challenges, Ethiopia can fully harness the potential of Islamic finance for the benefit of its economy and society.

The history of Islamic finance dates back to the era of Prophet Muhammad (Mohammad, et al., 2013). Islamic finance, with its roots in the teaching of Prophet Mohammed, boasts a long and illustrious history. From the early days of Islam until the 12th century, there are different Sharia-compliant financial instruments utilized in the Muslim world. Such as financial instruments accepting, bills of exchange (suftaja), cheque (sakk), and treasury (Baytal-Mal) were common (Chachi, 2005; Moahmmed, et al., 2013; Alharbi, 2015). The decline of Muslim civilization was mostly due to gradual deviation from Sharia, extravagance, lack of well-established organization, political breakdown, and the rise of different Islamic groups, and different wars that shifted the balance of trade from Muslims to Europeans. Accordingly, Muslims also lost their technological and economic advancement. Thereafter, the financial system of all Muslim countries went amiss from Sharia-compliance causing in the adoption of the western-based conventional financial system (Chachi, 2005).

While the roots of Islamic finance can be traced back to the era of Prophet Mohammed, its formal implementation began in the mid-19th century. However, it is important to note that despite its early beginnings; most Muslim countries eventually embraced the interest-based Western financial system.

In the 1940s, the idea of establishing an interest-free banking system gained significant momentum in the realm of theory, marking a significant milestone in modern Islamic finance. The first attempt to establish an interest-free bank took place in a rural area of Pakistan in the 1950s. This movement for interest-free banking quickly spread to the Arab world, leading to the establishment of the Mitrghamr saving house in Egypt in 1963, serving as a modern Islamic bank (interest-free banking).

An interest-free banking system under the paradigm of Islamic finance has been presented by the Sharia jurists as an alternative. Interest-free Islamic banking has been developed using three different models. The first model involves setting up full-fledged IFBs while the second model

involves setting up Islamic subsidiary banks and the third one is a dedicated window model within conventional banks.

1.2. Statement of the problem

The emergence of the Islamic financial system holds significant importance, as it is rooted in the comprehensive religious framework of Islam, which encompasses all aspects of the lives of its observant followers. Consequently, there is a pressing need for financial instruments that fully align with Islamic beliefs and principles.

Islamic finance prohibits activities such as gambling, interest-based transactions, speculative elements in financial contracts, and investments involving prohibited assets or activities. Instead, Islamic finance operates on three fundamental principles: equity participation, ownership, and profit-and-loss sharing (International Monetary Fund, 2015). These principles form the bedrock of Islamic finance and govern its operations.

However, the establishment and implementation of full-fledged interest free banks have given rise to challenges in coexistence with conventional banks offering Islamic windows or subsidiary services. The sources of funds for these conventional banks may not comply with Sharia, thereby raising concerns about unfair competition and the potential exploitation of Muslim investors. Nonetheless, certain contemporary scholars permit such banking services if specific Sharia conditions are met. These conditions include complete segregation of funds, the presence of a Sharia supervisory board, management committed to Islamic financial concepts, and protection of Muslim investors from negligence, trespass, and fraud, while complying with the standards of Accounting and Auditing (Yaquby 2000, cited in Jemal 2018).

Nevertheless, many Islamic banking clients maintain a belief that conventional banks engage in activities deemed immoral from an Islamic Sharia perspective. Consequently, a prevailing sense of suspicion and mistrust exists among the majority of interest-free banking clients toward these "Islamic windows" and their interest-free banking products. This explains the reluctance of numerous interest-free banking clients to engage in Islamic windows and their financial products (ALAwsat 2010, quoted in Jemal 2018).

In Ethiopia, the recent entry of full-fledged interest free banks in July 2021 have presented both opportunities and challenges in the finance industry. While conventional banks have already started offering Islamic finance through windows or subsidiary services, the new entrants must navigate legal, competitor, and regulatory restrictions. They need to be well-versed in the unique operational philosophy, principles, and practices of Islamic finance to provide comprehensive services such as deposits, financing, international trade, and non-cash facilities (Teferi, 2015).

This study aims to address the challenges and opportunities of full-fledged interest-free banking (IFB) services in Ethiopia. Specifically, it seeks to analyze key challenges related to establishing a robust regulatory framework, develop a skilled workforce, drive innovation, bridge awareness gaps, ensure sustainable liquidity, evaluate potential benefits, and provide solutions and recommendations. The study aims to inform policy decisions, guide stakeholders, and contribute to discussions on financial inclusion and economic development in Ethiopia.

Understanding the challenges and prospects associated with full-fledged IFB services in Ethiopia is crucial for unlocking its potential to contribute to a more inclusive, sustainable, and prosperous future for the nation. Thus, this study seeks to fill the research gap by examining the opportunities and challenges faced by full-fledged interest-free banking in Ethiopia, specifically focusing on its operational aspects in accordance with the newly enacted Directive No. SBB/72/2019. The findings of this study hold significant implications for policymakers responsible for issuing banking business regulations, as well as for investors interested in the full-fledged IFB banking sector. It is believed that a comprehensive understanding of the operational dynamics of Islamic banking in Ethiopia was contribute to the development and growth of this sector in the country.

1.3. Research question

1. What are the potential impacts of full-fledged Islamic banking on the Ethiopian economy and financial system?
2. What are the potential implications of Islamic banking for financial inclusion in Ethiopia?
3. What are the perceptions and attitudes of potential customers towards Islamic banking in Ethiopia?

4. What are the main challenges facing the growth and development of Islamic banking in Ethiopia?
5. How do cultural and regulatory factors impact the prospects of Islamic banks in Ethiopia?
6. How do skilled human resources and market competition influence the growth of Islamic banks in Ethiopia?
7. How has Hijra Bank performed financially over the past three years?

1.4. Objectives of the study

1.4.1. General objective

The general objective of this study is to examine the challenges and prospects of full-fledged interest-free banking in Ethiopia.

1.4.2. Specific Objectives

- ❖ Examine the potential effect of Islamic banking on financial stability and risk management in the Ethiopian financial system.
- ❖ Assess the potential challenges and opportunities for expanding financial inclusion through Islamic banking in Ethiopia.
- ❖ Explore the awareness and understanding of Islamic banking among the general public in Ethiopia.
- ❖ To assess the influence of skilled human resources and market competition on the growth of Islamic banks in Ethiopia.
- ❖ Assess the cultural acceptance and alignment of Islamic banking with the values and beliefs of the Ethiopian society.
- ❖ To assess the perceptions and attitudes of potential customers towards Islamic banking in Ethiopia.
- ❖ To assess the three-year financial performance of Hijra Bank.

1.5. Significance of the study

The finding of this study lies in its contribution to the understanding and development of full-fledged banking in Ethiopia, specifically within the context of Hijra bank. By analyzing the challenges faced by Hijra bank being full-fledged interest free banking service and exploring

potential opportunities and prospects, this study offers valuable insights into the functioning and operations of full-fledged interest free banks. The findings of this study was provide a comprehensive understanding of the specific obstacles and potential avenues for success in the realm of full-fledged interest free banking, making it a valuable resource for policymakers, regulators, and stakeholders. This study was aid in making informed decisions to enhance the effectiveness and impact of full-fledged interest free banking services in Ethiopia, thereby contributing to the growth and development of the banking sector in the country.

1.6. Scope of the study

This is study is to analyze the specific challenges faced by Hijra bank in providing interest-free banking service. The study aims to identify and evaluate the obstacles encountered by the bank in operating full-fledged interest free banking model. Additionally, it aims to explore the potential opportunities and prospects for the growth and development of full-fledged interest free banking service within the context of Hijra bank. This study was cover a time period of three years, from 2021 to 2023. The finding of this study was contribute to a deeper understanding of the challenges and prospects of interest-free banking, the finding of this study was contribute to a comprehensive understanding of the challenges and prospects of interest-free banking and may provide insights for the boarder development of interest-free banking service in Ethiopia. Particularly in relation to Hijra bank.

1.7. Limitations of the study

Since full-fledged interest-free banking is relatively new to the Ethiopian market, there is limited-service experience available. As of now, there are four full-fledged interest free banks in Ethiopian financial sector two of them commencing operations in 2021 and the remaining two banks officially starts operations in 2023, the available service experience is still relatively limited. Due to the newness of full-fledged interest-free banking in Ethiopia, finding well-organized, adequate, and long-term data for a comprehensive study can be challenging. It is important to acknowledge these limitations when conducting a literature review and consider the available data sources, such as reports, studies, and industry publications, to provide a thorough analysis within the given constraints.

1.8. Organization of the paper

The study has five chapters, the first chapter deals with the problem and its approach which includes an introduction, background of the study, statement of the problem, objective of the study, significance of the study, scope of study, limitation of the study, and organization of the research. Chapter Two provides theoretical and empirical literature about interest-free banking, and then chapter three presents the methodological concerns used in conducting the research, including the research designs, sampling, technique, method of data collection, data collection instruments, method of data analysis, and so forth. Chapter four gives details on data presentation, analysis, and interpretation of the study. The last chapter was about the conclusion and recommendations based on the findings of the study.

CHAPTER TWO

2. REVIEW OF RELATED LITERATURE

2.1. Introduction

The second chapter of this study focuses on providing a comprehensive literature review of theoretical and empirical literature reviews related to interest-free banking systems. The theoretical section will give the reader a better understanding of the foundational principles and laws resulting from the Islamic faith that govern the operation Islamic banks. Additionally, it was explored the most commonly used interest-free financial products within the area of banking performance in accordance with Shaira principles. In the empirical review section, was discuss into the previous studies related to interest-free banking conducted at the nationwide level. Specifically examining existing empirical review, this study aims to build upon the current knowledge and contribute to the understanding of interest-free banking system at both international and Ethiopian Level

2.2. History of Islamic banking in Ethiopia

Ethiopia, a country with a significant Muslim population, has around 34% of its total population identifying as Muslims, as reported by the central statistics Authority of Ethiopia census 2007 (CSA 2007). However, despite this sizable Muslim population, Ethiopia faces low bank service penetration rates from the total population. According to the Global Findex Database 2022, only 46.48% of adults aged 15 years and above have access to the bank account. Leaving overwhelming 53.52% of adults without access to basic financial service in the country (World Development Indicator, Data Bank). this highlights a substantial gap in financial inclusion and underscore the potential significance of addressing this issue by exploring and promoting

interest-free banking service provide to the needs of the Muslim and other population and contribution to the overall growth and development of the banking sector in Ethiopia.

The unavailability of Sharia-compliant financial products and services in our country has contributed significantly to the issue of financial exclusion and the low utilization of banking services (Hailu, Kapusuzolgu, and Ceylan, 2019). Prior to 2008, there was no legal framework in place to support the establishment of Islamic finance in Ethiopia. However, the demand from Ethiopian Muslims for the establishment of full-fledged interest free banks has been persistent for decades. In 2007, representatives from the Ethiopian Muslim diaspora community applied a requisition to the late Prime Minister Meles Zenawi. Among this requisition was the request for authorization to establish full-fledged interest free banking in Ethiopia (Feyissa, 2012). Subsequently, in 2008, a group of entrepreneurs and leaders from the Muslim community established an interest-free bank called "ZamZam Bank." They emphasized the benefits and importance of full-fledged interest free banking (Islamic finance) during a meeting with the late Prime Minister. In response, the Prime Minister instructed the National Bank of Ethiopia (NBE) to issue a new proclamation that permitted the establishment of interest-free finance in Ethiopia (Al-Hashimi, 2012). Consequently, NBE proclaimed banking business: Proclamation No: 592/2008. In this Proclamation Article 22, sub-article 2 states "The National Bank may issue a directive to regulate banking business related to non-interest-bearing deposit mobilization and fund utilization."

This was the first practical step taken by the national bank of Ethiopia (NBE) to adopt the practice of Islamic finance in Ethiopia. According to proclamation No: 592/2008, Article 22, sub-article 2, all conventional banks in Ethiopia began accepting interest-free deposits from customers interested in Islamic banking service. With depositors seeking a safeguard for their funds, a significant amount of money was deposited in all conventional banks through IFB window service, as well as in the parallel Zamzam bank initiated the sale of shares in December 2010 to establish a comprehensive Islamic finance bank.

Although the minimum paid-up capital required to establish was 75 million Ethiopian birrs (equivalent to 2.7 million USD), Zamzam bank successfully raised 137 million birrs (equivalent to 4.9 million USD), exceeding the NBE's required paid-up capital by almost twice the amount.

The achievement was accomplished within four months, with contributions from more than 6,800 subscribers (Zamzam bank under formation 2012).

However, the establishment of a full-fledged interest free Islamic bank in Ethiopia faced a setback when the NBE issued a new directive called "Directives to Authorize the Business of Interest-free Banking No. SBB/51/2011." This directive limited interest-free banking to being offered only through windows within established conventional banks. According to Article 2, Sub-article 3 of this directive, an interest-free banking window is defined as a unit within a conventional bank exclusively offering interest-free banking services. Unfortunately, the government did not provide any explanation as to why this directive contradicted the previous one.

Despite this setback, the Ethiopian Muslim community persevered, and after seven years, their dream of a Sharia-compliant interest-free bank became a reality. In May 2019, the NBE issued Proclamation No: 1159/2019, which allowed for the establishment of full-fledged interest-free banking in Ethiopia by amending the banking business proclamation. Article 59 of this proclamation is specifically dedicated to "interest-free banks," and Sub-article 1 states that, "without prejudice to the requirements specified under the provisions of the proclamation, the National Bank may issue a directive to prescribe additional conditions of licensing, supervision, and requirements to establish an interest-free bank. An interest-free bank is defined as a company licensed by the National Bank to undertake only interest-free banking business." This proclamation made the establishment of a full-fledged interest-free bank a reality in Ethiopia.

Following the promise made by the current Prime Minister and the issuance of Proclamation No: 1159/2019, several shares have lined up to request licenses from the NBE to provide full-fledged IFB services. Nejashi and Zad are in the process of establishment, while ZamZam Bank became the first fully operational interest-free bank in 2021. Shortly after, ZamZam Hijira, the second bank, also opened its doors. Both banks commenced operations in July and September 2021 "source banksethiopia.com and addisfortune.news". Additionally, Shebele and Rammiss Banks are expected to become operational as interest-free banks. Shebele Bank, which is Somali-owned, previously operated as a Somali Microfinance Institution (SMFI) starting in 2011 and completed its transition into an interest-free bank in July 2021, with operational commencement in 2022. Rammiss Bank is set to commence operations in 2023.

2.3. Definition of an Islamic Bank

The term Islamic banking refers to a full set of banking operations following the principles of Islamic law, Sharia. Islamic finance principles substantially differ from conventional (capitalist) finance, as it is beyond pure financial issues. Even though, Islamic law prohibits the collection and reimbursement of interest and also from the prohibited incomes such as trading of pork, gambling, and others. Muslims' earnings must come from permissible means of income, and must also be spent on religiously acceptable categories of expenditure according to the Quran and Sunna. Thus, Islam prohibits investing in a business that is considered unlawful or contrary to Islamic teachings and values (Dusuki 2006, Cited in Ahmed 2012).

Islamic finance has a long history, dating back to the time of prophet Mohammed PBUH, and has evolved from a theoretical concept to a practical reality over the past 1445 years. It has not only gained traction in Muslim majority countries but has also spread to non-Muslim nations. Muslims seek financial services that meet with Islamic law, as they strive to structure challenge of reforming financial institutions, products, services, and contracts to be interest-free and compliant with Islamic regulations. The goal is to establish a just, ethical, and socially inclusive financial system that supplies to the needs of Muslims while following to the principles of Islamic law (Ahmad M.Abu-Alkheil 2012).

Čihák and Hesse (2008, p.4) Cited in Entissar Mohamed Elgadi 2016 define Islamic banking as “the provision and use of financial services and products that conform to Islamic religious practices and laws”. Although these definitions have introduced an Islamic banking system in terms of its operating principles, rules, and products, it lacks the important component of land regulation. The definition does not consider where the Islamic banks trade (which may have rules they may have to abide by). The land law component was considered when defining Islamic banking by Ebrahim and Joo who in 2001 gave a more comprehensive definition in which they report that “an Islamic bank is one that by its own choice opts to comply with two sets of law: the law of the Land (Jurisdiction); and the Islamic Law (Sharia)”. Therefore, Islamic banks need to reconcile their positions to coordinate between the possible conflicts that can appear when having some lands in non-Islamic law countries.

All the above-mentioned definitions agree that the uniqueness of the Islamic banking system lies in its objective. This shows the clear freedom of the ways of achieving profits to fulfill with

ethical, economic, social, and political restrictions of the Islamic laws accordingly following the Quran and Sunnah. Islamic banks are established to hold their activities in strict obedience to Islamic Sharia rules and moralities that prohibit Interest (Riba).

2.4. About Hijra bank

Hijra Bank was established in January 2022 following the Ethiopian government's approval of full-fledged interest-free (Islamic) banking. This was a breakthrough development, as the country's Muslim community had long been financially excluded due to the absence of Sharia-compliant banking options.

Hijra Bank was founded with a core mission of inclusion and observance to Islamic principles. Unlike many Ethiopian banks that cater to narrow urban choice, Hijra started with a diverse customer base of over 9,000 small farmers, pastoralists, and small traders from across the country. This inclusive philosophy extends to the bank's branch network, resource allocation, and staff recruitment.

Within its first year of operations, Hijra Bank has built a strong reputation for strictly following Sharia-compliant practices. All products and services are inspected by a Sharia Advisory Committee and the bank uses AAOIFI-certified Sharia-compliant software.

With 45 branches and over 185,000 customers, Hijra Bank is one of the fastest-growing banks in Ethiopia. It has also embraced digital channels to enhance financial inclusion. Beyond banking operations, the institution plays a leading role in promoting awareness and acceptance of interest-free banking in the country. “Hijra bank official website”

The case study of Hijra Bank's development provides valuable insights into the challenges and prospects of interest-free banking in the Ethiopian context, which can inform the overall proposal on this topic.

2.5. Principles of an Islamic financial system

A base behind financial systems, whether it is conventional or Islamic, is to utilize the resources in an ideal method, by directing or redirecting these resources to diverse investment projects, to get profit maximization. Nonetheless, the main sources that rule the Islamic financial system aren't solely Profit-maximization. Profitability is neither the only nor the key factor to the theory

of Islamic finance. The Sharia rule, which governs Islamic finance, is characterized by an integrated and comprehensive framework that directs an economic, social, and political life (Derbel et al., 2011). Thus, the principles of an Islamic system reflect the interest of Sharia in the values of the financial structure of other aspects. (Derbel et al. 2011) report that the object of such a system lies in the aspiration to ensure that dissimilar Islamic financial products are compatible with the legal and moral values of Islam, the following section explains the main principles of Islamic finance follow, which are founded by both Sharia and rulings, known as fatwa (explanation or answering according to the Hidath), issued by Muslim scholars. These principles are prohibition of interest Riba, as well as risk sharing profit and loss sharing, activities with uncertainty (Gharar), gambling (Maisir) activities, the production and sales of goods prohibited in Islam by Quran or Hadith, and final Zakah.

2.5.1. Prohibition of interest Riba in Islam

Riba is an Arabic word for “growth” or “Increase” and means the payment or receiving interest from the money that is used. The Quran, the holy book of Islam (Quran), Loud and clear forbids Riba, which includes any payment of interest on monetary loans. The prohibition of Interest (Riba) in Islam is purely from the Quran and the Sunnah (the sayings and doings of the prophet Mohammed SAW). Interest (Riba) is restrictedly prohibited in the Quran, and interests receiving or paying are forbidden in Islam.

According to the Islamic financial system, exchange between buyer & seller is considered permissible. The reason behind the prohibition of interest is that it enables the accumulation of wealth by a particular group of society, leading to an increase in the wealth of the rich (lenders), and the poverty of the poor (borrowers) this allows the lenders to become wealthier at the expense of the borrowers.

According to the Islamic principles, there are two types of Riba;

1. Riba al-nasi'ah (nasi'ah means delay) this kind of Riba occurs when there is a delay in payment of outstanding debt, whether the debt is an outcome of sold commodity or money borrowed. In other words, the borrower exceeds the time allowed to refund the money, they was expected to pay an additional amount of interest occurred. It is an

arrangement of loans with is premium on the top of the principal amount that is being borrowed until specific data.

2. Riba al-fadl surplus Riba (excess in spot transaction) is a transaction with kinds of goods. This al-fadl Riba is more concerned with six kinds of goods (gold, silver, wheat, barley, salt, and dates) which are forbidden by Islamic Sharia from being traded for the same type of items but with a difference in amount. An example of this kind of Riba is the selling of gold and pearls in one transaction for a price that does not represent the market price. Another example is selling a kilogram of wheat for two kilograms or selling a unit of gold for two units, whether this has been specified in advance or because the buyer has faced some difficulties in returning the basic amount.

2.5.2. Profits and Loss Sharing (PLS)

Sharia prohibits Muslims from earning income by charging interest but it permits income generation through the sharing of loss and profit (Mudharabah) between the parties to a transaction. Islamic financial philosophy believes in profit and loss sharing modes of finance presented Mudarabah (Joint venture) and Musharakah (partnership & collaboration) (explained later in this chapter) as an alternative to predetermined interest. This Profit and loss sharing system is believed to encourage people to become partners and work together rather than entering into a creditor-debtor relationship. Partnership means the mutual responsibility of two or more persons for the outcome of a financed project, which is believed to increase the possibility of success of the project. The indirect aim of the partnership approach is that such increase successful ventures and provide incentives to the economy (Bala, S. and Zaha, R. 2009).

Overall, in this Profit-loss sharing the financier becomes a partner or investor instead of a lender and the profit and loss was shared for the profit sharing it was according to mutual agreement, and for the loss the sharing was the proportional to how much the financier share in total financing.

2.5.3. Prohibition of Activities with Elements of Gharar (Uncertainty)

According to Ibrahim et al., (2012) and Derbel et al, (2011) Cited in Entissar Mohamed Elgadi 2016, the concept of Gharar refers to any business activity or trade in which the terms and conditions of the contracts are highly uncertain, unclear, risk, or characterized by dishonesty.

The uncertainty in this situation covers the nature, quality, and price of products/services in the contract and/or the specification of the rights and obligations of the contracting parties.

Generally, Gharar happens when there is lacking relevant information or any important information related to the commodity/service under the contract that can lead to ambiguity and exploitation or abuse by one of the contracting parties. This means when one of the contracting parties cheats the other party. According to Ebrahim and Joo (2001), the exchange is prohibited only if its terms implicate deception based on the absence of knowledge related to the goods: that is, if the goods cannot be supplied by the seller or the goods are not well described in terms of type, quantity or quality.

2.5.4. Prohibition of Maisir (Gambling Activities)

Gambling is referred to as Maisir in Arabic, which means any action that includes a deal between two or more parties, each of whom agrees to take a risk of loss; where this loss becomes the gain for the other party without assuming any risk or making proportionate efforts. AL Manaseer (2009) reports that the gain resulting from such a random speculation deal is considered immoral and prohibited in Islam, for the sake of preventing individual interest from deviating from the positive employment of resources to acquiring and gathering wealth with no effort. Ibrahim (2009) argues that non-Islamic banks are criticized for undertaking activities that involve such kinds of deals (speculation and conventional insurance).

2.5.5. Prohibition of the production and sale of goods and services that is prohibited in Islam

Ali and Farrukh (2013) Cited in Entissar Mohamed Elgadi 2016 report that to accomplish the ambition and purposes of an Islamic financial system, Islamic banking is expected not only to keep away from interest-based dealing prohibited in Islam but also from been thrown in unethical transactions which may lead to the society's or individuals' destruction or impairment. Contribution in such transactions is firmly prohibited in Islamic Sharia as one of its main concerns is to positively engage with the community in order to attain both economic and social growth and prosperity. Chong and Liu (2009) provide examples of these sorts of activities by reporting that Islamic banking is not allowed to deal in business that has anything to do with

alcohol, pork, tobacco, armament, and prostitution. Overall in Islam, the activities are prohibited by the Quran.

2.5.6. Zakah

Zakah is an amount of money that every Muslim whose wealth surpasses a set limit that is mentioned in the Quran by the sunna is required to pay to the needy in Islamic society.

Unlike Charity, Zakah is compulsory and its amount is defined by Shaira. Samad (2004) defines Zakah as an obligatory religious sum or tax on the wealth of the rich payable to the needy. The basis behind Zakah is to redistribute wealth to offer a fair standard of living for the poor.

Zakah is one of the five pillars of Islam; therefore, all Islamic banks are required to pay Zakah on their earned profits. Thus, Islamic banks pay two taxes, Zakah, and corporate business tax (profit tax) to the government. The Islamic banking system developed a new service through which they can collect Zakah from the eligible Muslim Society.

2.6. Islamic Banks' Uses of Funds or Islamic Banks Modes of Finance

Islamic banks are forbidden from paying or receiving interest according to the Sharia law, The Islamic financial system practices both Sharia law and previous experiences to form suitable and practicable modes of finance.

(Abdul Rahman 2007) Cited in Entissar Mohamed Elgadi 2016 reports that the practice of Islamic banks is governed by Islamic rules on transactions, known as "Fiq Al-Muamalat", which utilizes special Islamic Sharia arrangements for structuring the main outlines of Islamic modes of finance. According to these types of finance, the profitability of the project is considered to be the important factor of financing, not the client's credit value and solvency or the securities and collaterals. This type of financing gives place to the economic morals and ethics that unite both material and spiritual qualities to demonstrate its system and accomplish its objectives (Ariff, 1988 and Dusuki and Abdullah, 2007).

These instruments have been explained by Haron (1996) who reports that Islamic modes of finance are classified into the following three groups

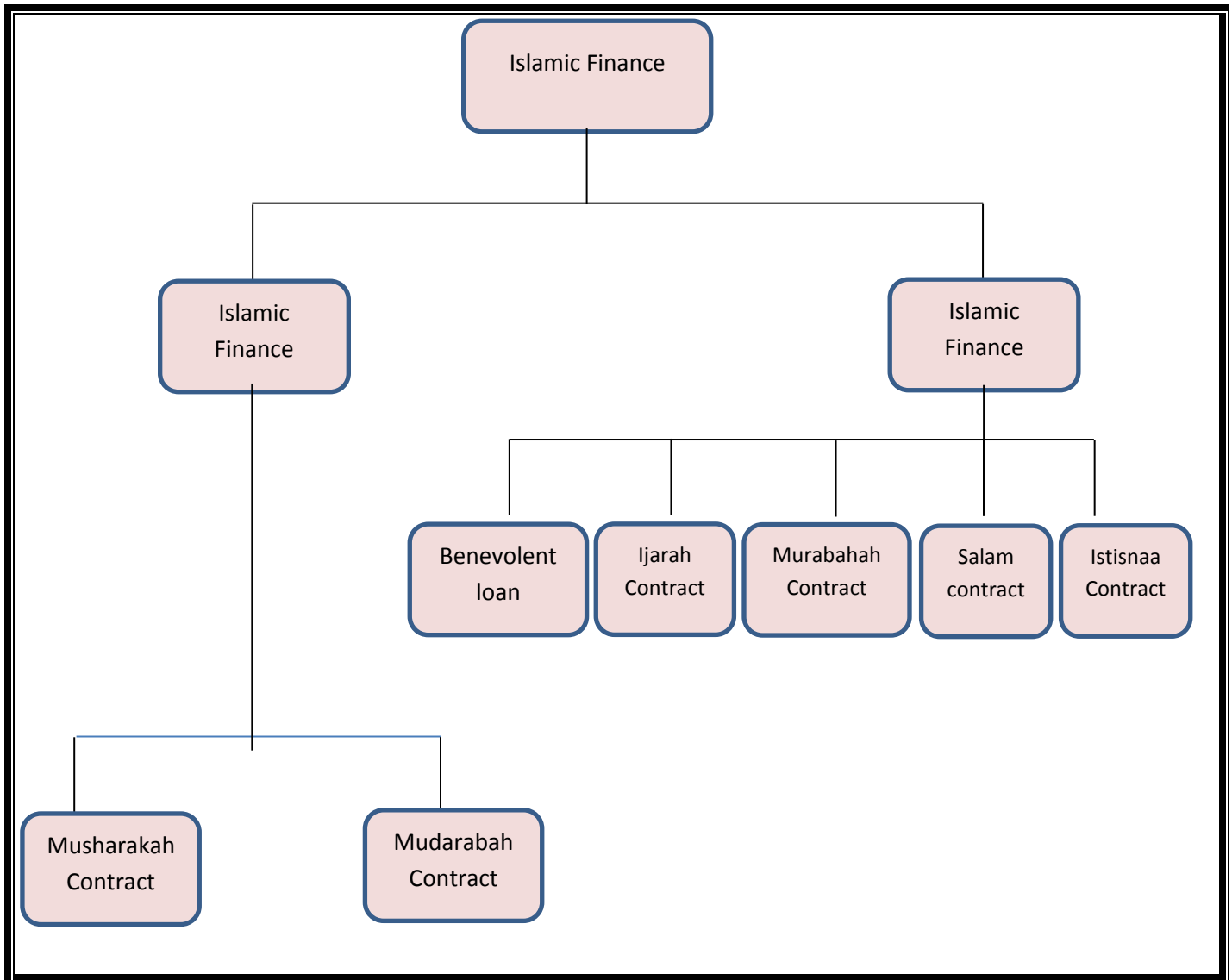
- a. Types that are founded on Profit and loss sharing PLS
- b. Types that are founded on fixed charges non-PLS

c. Free from charge Types.

The types Mudarabah (Trust-finance) and Musharaka (joint-venture) these types are types of PLS of finance, while types such as Murabaha (cost plus profit markup), Bai-Salam (advance purchase or sales contract) and Ijara (lease) these types are type of fixed charges non-PLS. finally, the type of Qard Hassan (benevolent or interest-free loan) is the only type of free charge principle. The structure of the Islamic types of finance is illustrated in Figure 2.1.

Figure 2.1: Structure of Islamic finance

Differentiate between the two forms of Islamic finance

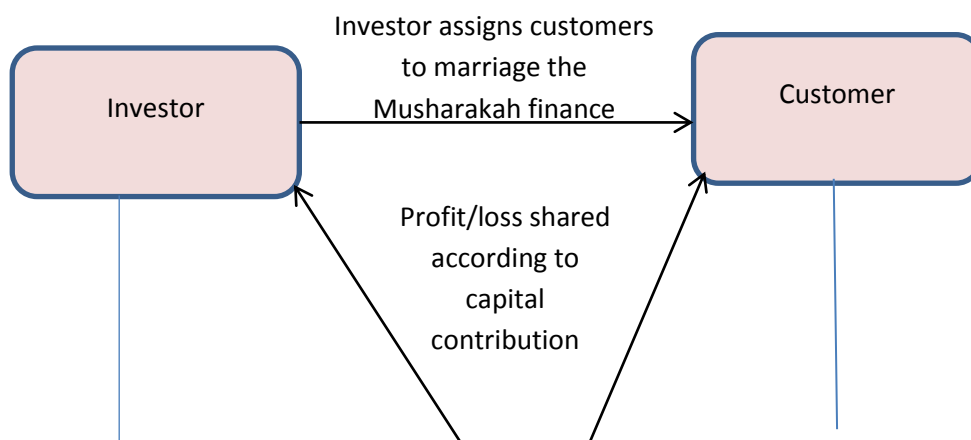


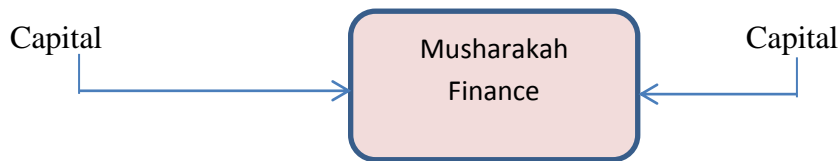
Source created by the author

2.6.2. Musharakah (Joint venture of loss and profit)

Musharakah is when both parties contribute capital to the venture and share in both the profits and losses in total, we can say it is a joint venture between two or more parties. Based on Audu Bello et al. (2014) Musharakah is a contract in which two or more persons contribute capital for the establishment of a particular business venture in such a way that each partner has the right to either be involved in the administration of the business or not. However, partners may decide to be a speaker or sleeping partner at their own was. In this kind of transaction, profits are shared based on their agreement ratio which needs not be equal to their capital contribution, but loss is shared strictly based on individual capital contribution. So, the Islamic bank was act as a partner in this case in order to contribute to the capital formation as well as in sharing profits and losses. Based on Ahmed (2000), Musharakah or partnership is a type of investment whereby 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. It is also common that Musharakah's contract ends with the transfer of the project ownership to the business partner. The structure of the Mudarabah contract is illustrated in Figure 2.3

Figure 2.3: The structure of Mudharabah





Created by the author

2.6.3. Murabahah (cost plus profit markup)

Is the major financing product used for financing to all sectors in the form of working capital, purchase of goods/assets, export and import trade, project financing, ETC. Murabahah is an Arabic word that means it is win-win it is a plus for the company purchasing a good or item and selling it to the client on base of cost-plus profit markup, is the major financing product used for financing to all sectors in the form of working capital, purchase of goods/assets, export and import trade, project financing, ETC.

It's an agreement between three parties the bank, the client, and the original seller/supplier. The bank purchases the meant asset from the original seller. After acquiring the asset, the bank resells it to the client after agreeing on a predetermined resale price based on cost plus markup price (profit margin). Customer payment method and whether it should be paid in full upon maturity or by installments was be specified in the contract made between the two parties

2.6.4. Bai-salam (advance purchase or sales contract) or postponed delivery

It is a type of Islamic financing through which the bank pays the full contract price of goods or commodities in advance that was be delivered by the supplier at a specified time and date in the future. Therefore, the bank makes an advance payment to the customer who uses this payment to finance the production of his project. The bank sells the same goods or commodities to the third party through, an independent contract agreement, such as agricultural products.

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

2.6.5. Istisna (commissioned manufactured)

Is a contract of sale of specified properties/assets to be manufactured or constructed with an obligation on the part of the bank now to be called the seller to deliver them to the buyer/customer/purchaser upon the completion as per the agreed complete specifications of goods/assets/services or manufactured items, sales price date and place of delivered. The unique feature of istisna' (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, istisna' contract could be directly between the end user and the manufacturer, also it is a three-part contract, with the bank acting as a middleman.

2.6.6. Ijarah (Lease)

Ijarah is an Arabic word that means Lease Ijarah is a long-term rental agreement; it is similar to leasing in conventional banks but subject to certain conditions that obey Islamic Shariah. Within this mode of finance, the Islamic bank (the lessor) should purchase the assets such as property, vehicles, machines, etc. before conducting the Ijarah contract. After getting the assets, the bank rents the assets to the client (the lessee) who pays the rent at regular intervals. During the lease term, the ownership of the assets remains with the bank (lessor) while the client (lessee) only has the obligation to use the asset. Also, as a safeguard for the bank, the lessee has to provide collateral that was be proportional to the damage. The bank is accountable for monitoring the asset's usage. If it requires any maintenance but not due to wear and tear the Islamic bank calls for employing a suitable maintenance unit for the purpose of maintenance. The bank is also accountable for the risk related to the assets. At the same time, the lessee was accountable for safeguarding the asset (Abdul Rahman, 2007 Amba and Almukharreq, 2013).

A developed type of Ijarah is Ijarah Muntahia Bitamleek (which means the lease was transfer ownership to the lessee). Ibrahim et al, (2012) reported that within the concept of Ijarah the possession of the assets was be transferred to the lessee at the end of the contract and the other hand Abdul Rahman (2007) reports that the asset ownership was be transferred to the lessee by one of three ways: 1st, the transferal occurs at the price that has already been fixed at the time of the contract, 2nd the transferal happened through progressive and gradual transferal of ownership during the period of the contract, finally 3rd the ownership can be transferred as a gift or taken price, as the sale price has already been paid through the installments.

2.6.7. Ijarah thumma al bai' (hire purchase)

This is also another part of leasing but with additional features. The first leasing technique is Ijarah which is the full process of renting out assets for a specific amount of time. This second process is called Bai (selling). In this case, when that specific time of renting is finished, the trading or buying procedure is activated. There is going to be a contract between the two parties. For that contract, the bank was first assessed it is profit by considering different parties like the time value of money. The price of the property, the depreciation of the property after the leasing period, and other aspects, after that, the contract was made between the two parties after ensuring the profit of the bank.

2.6.7.1. 'Ijarah-wal-iqtina'

This system already used by an interest-free bank leasing out a property to the user in which there was be a contract that was be transferring the property under the rental leasing technique which may be a vehicle, a field, a house, or other property was be under the user's name or transferred to the user when the period of the lease contract agreement ends. In this contract when the duration of the lease contract under the rent is over the property was be sold to the user without looking for additional benefits that may be agreed up on the contract. The bank as usual calculates its profit from rent and at the end trade which are fixed amounts from the time that the contract is set out.

2.6.8. Musawamah

When two parts of the trading process have conclusive references of the price that they aim to offer, it is called Musawamah. In this case, the seller and buyer of the goods was negotiated without necessarily knowing the cost of the product or property. In this case, even if the seller or the buyer does not know the price of the item that they are about to trade, neither one of them is required to disclose the true price of the item while they are negotiating. This method is used very often as it may be more profitable than Murabaha with only this difference in disclosure requirement. In general, it is a kind of sale in which the price of the item to be traded is specified between the seller and the buyer without knowing the price paid or the cost incurred by the former.

2.6.9. Wakallah

This refers to an agency or representation contract. It is a type of agreement in which one party appoints the other party to act on their behalf in a specific matter. There was be two parties called the principal and the agent “wakil”, wakil means agent in Arabic. The agent “waki” l is given the authority to make decisions and take actions on behalf of the principal but is also held responsible for the consequences of those actions

2.6.10. Kafalah

The facility is a written promise/irrevocable obligation issued by the bank to compensate (pay a sum of money) to the beneficiary (local or foreign) in the event that the obligator fails to honor his/her/its obligations by the terms and conditions of the guarantee/agreement/contract. The bank issues various types of Kafala for various purposes upon the request of its customers.

2.6.11. Qardh Hasan (benevolent or interest-free loan)

Qardh Hasan represents another case of Islamic finance that is on a zero-return basis. In other words, the borrower repays the same amount they initially borrowed from the bank without any interest payments (interest-free loan). The borrower usually has to refund the loan he took within a predetermined period of time; the repayment terms are normally installments that are written on the agreement. (Abdul Rahamna, 2007 and Khan et al, 2007). Additionally, Abdul Rahman (2007) reports that entrepreneur who has good potential to make full payments and require instant cash are more likely to be chosen for this kind of interest-free loan. He also reports that as the Islamic bank was bear the credit risk, they need to select the accurate technique to ensure that the installments was be received as agreed. Shahinpoor, (2009) argues that Qardh Hasani is often given to charitable institutions or people with an unexpected need for funds (such as a natural disaster), therefore, Qardh Hasan is expected to give both financial and moral support to the borrower.

In Hibah, the institution that works with depositor customers wasingly gives an extra gift from the profit it made. In this case, when the financial institution extends the payback time on a loan, for a customer in total wasingness the customer may pay the loan with more money than the amount they were loaned. This practice of customers paying extra for their extended loan payback period is voluntary for both the bank as well as the customer, and neither party is obligated to do so.

In interest-free banking, the process of lending and borrowing money should be totally interest-free and no one should work with interest paid for the time value of money that they loaned or deposited because of the prohibition of Riba. But in this case, since the activity is done through total free was, some Islamic religious experts argue that it is an acceptable practice since the extra payment is not done to overcome monetary depreciation.

After discussing the uses of funds in Islamic banking it is appropriate to know that the above-mentioned set of modes of finance represent neither all the potential contracts that Islamic law permits nor are those used in practice. Generally, there is a good opportunity for innovating in the formation of new types of contracts, as long as there is no prearranged interest charge or other contradictions with the principles of an Islamic Financial system.

2.7. Empirical Review

While there are numerous studies exploring the prospects and challenges of full-fledged interest-free banking, there is a notable scarcity of research specifically focused on full-fledged IFB banks operating in Ethiopia. Consequently, this section aims to review the available empirical evidence both globally and within Ethiopia. The empirical review was examined the prospects, challenges, determinants, legal frameworks with sharia, and the practical application of interest-free banking, with a particular emphasis on recent studies. However, the studies on full-fledged interest free banks in Ethiopia was before they were commencing. Additionally, the review was explored how interest-free banks in Ethiopia navigate and adhere to the principles of Sharia law in their operations. By creating and analyzing the empirical evidence, this review aims to boost our understanding of interest-free banking in Ethiopia and identify areas for further research and exploration.

2.7.1. Review of previous studies outside of Ethiopia

Ahmed Alharbi (2015) made a study on development of the Islamic banking system in his article; Alharbi provides a comprehensive historical overview of the Islamic banking industry. He traces the origins of Islamic finance back to the early days of Islam and highlights the development of Islamic banking practices over time. The article discusses the decline of Islamic finance and the adoption of Western banking models, as well as the resurgence of Islamic banking in the mid-20th century. Alharbi also explores the influence of Islamic banking practices on the development of commercial credit papers and the impact of European banking models on

Islamic countries. The article concludes by discussing different perspectives within Islamic societies regarding the European banking model. Overall, Alharbi's article offers valuable insights into the historical development of Islamic banking.

Zamil and Aiza (2014) conducted an empirical study on the challenges faced by Islamic banking in Malaysia. They identified issues such as the influence of the window banking system, lack of regulatory support for Sharia-compliant products, and non-compliant offerings. Inadequate operational practices, a lack of human resource expertise, and deficiencies in responsibility, accounting, and auditing were also found. The study highlights the need for improvements in regulatory support, compliance, operational efficiency, human resource development, responsibility, and accounting and auditing practices in the Malaysian Islamic banking sector.

Tabash (2017) conducted a study using the analytic hierarchy process to identify the critical challenges facing Islamic banking in India. The findings revealed several key challenges, including the absence of a proper regulatory framework, a lack of experts in Islamic banking, low awareness about Islamic banking, the absence of standard-setting and inadequate collaboration and harmonization between Islamic banks. These challenges highlight the need for addressing regulatory gaps, enhancing expertise, increasing awareness, establishing standards, and promoting collaboration among Islamic banks in India.

According to a study conducted by Aden (2014) in the Arabian Gulf, deposits in Islamic banks are increasing rapidly, posing a potential risk for conventional banks as they may lose 30-40 percent of their Muslim clients to Islamic banks. In a study conducted by Jaffar and Manarvi (2011) titled "Performance Comparison of Islamic and Conventional Banks in Pakistan," was discovered that Islamic banks demonstrate superior performance in terms of having sufficient capital and a stronger liquidity position. On the other hand, conventional banks excel in management quality and earning ability.

Additionally, Elgadi's assessment in 2016, which focused on evaluating the financial performance of Sudanese banks, revealed that Islamic banking has a positive impact on bank profitability. This is supported by the encouragement from the Central Bank of Sudan to use Islamic financing in all economic activities. However, the study also identified a management gap within the interest-free banking system.

"Islamic Banking and Finance in Nigeria: Exploration of its Opportunities and Challenges" by Ahamad Faosiy Ogunbado, Umar Ahmed, and Yusuf Abubakar (2017) falls short in providing detailed analysis of the opportunities that Islamic banking and finance can offer Nigeria. While the authors acknowledge the potential benefits, such as economic growth and financial inclusion, they do not extensively explore these aspects or provide empirical evidence to support their claims. A more comprehensive empirical review could have included case studies or data from other countries that have implemented Islamic banking and finance, highlighted the positive outcomes and impacts on various sectors of the economy. By incorporating more empirical evidence, the paper would have strengthened its arguments and provided a more robust analysis of the opportunities presented by Islamic banking and finance in Nigeria.

Bananuka, Kaawaase, Kasera, and Nalukenge (2019) conducted a study on the determinants of the intention to adopt Islamic banking in Uganda. They found that attitude and religiosity significantly influence the intention to adopt Islamic banking, while subjective norm's predictive power is encompassed by attitude. The study included data from 258 managers of micro businesses in Uganda and used a hierarchical regression analysis. This research contributes to the understanding of Islamic banking adoption in non-Islamic developing countries and provides insights into the combined influence of attitude, subjective norm, and religiosity on adoption intentions.

2.7.2. Review of previous studies on Ethiopia

In 2019 Ahmed, examined the Ethiopian interest-free banking proclamation following the implementation of Directive No. SBB/72/2019. According to Ahmed, there is no distinction between Proclamation No. SBB/51/2011 and Directive No. SBB/72/2019. Additionally, the existing legal framework in Ethiopia is deemed inadequate for the establishment of comprehensive interest-free banking. Consequently, there is a requirement for a favorable legal framework to enable the implementation of full-fledged interest-free banking in Ethiopia.

A study titled "Prospects, Opportunities and Challenges of Islamic Banking in Ethiopia" conducted by Mohammed in 2012, it was conducted before the actual implementation of IFB service in Ethiopia but the researcher has identified several potential obstacles that may arise. These challenges include a lack of awareness among the population, regulatory and institutional

hurdles, insufficient support, a gap in research and development within Islamic studies, a scarcity of qualified personnel, and the misguided association of the service with a particular religion and global terrorism.

In other study conducted by Suadiq Mehammed HAILU and Ömer Faruk TEKDOĞAN (2023) the study titled ensuring the compliance of Islamic finance applications with Shariah principles in Ethiopia: in there study they emphasizes the significance of ensuring compliance of Islamic finance practices with Shariah principles in Ethiopia. The absence of a well-defined Shariah governance framework poses challenges and potential risks to the industry. By adopting international standards, establishing a centralized Shariah advisory committee, and fostering collaboration among stakeholders, Ethiopia can enhance Shariah compliance and promote the growth of Islamic finance in the country. Further research and practical implementation of recommended measures are crucial for achieving sustainable compliance in the Ethiopian Islamic finance sector. Based on the experiences of Turkey, Malaysia, Kenya, and South Africa, the authors propose establishing a centralized Shariah advisory committee under the NBE to ensure compliance with Shariah principles in interest-free finance applications in Ethiopia.

Suadiq Mehammed Hailu *Ibrahim Bushera** (2020) conducted a prospect and challenges of interest free banking in Ethiopia. The study reveals significant opportunities for Islamic finance in the country, including a large unbanked population and high demand for interest-free financial services. However, the review also identifies challenges such as negative public perception, legal framework issues, limited investment options, tax complexities, lack of controlling mechanisms, and a shortage of skilled resources. The authors recommend further research on factors influencing public perception, legal and regulatory adjustments, and addressing the shortage of skilled resources. This study provides evidence-based insights into the prospects and challenges of interest-free banking in Ethiopia, emphasizing the need for policy decisions and industry development based on research.

The Progress to Allow Full-Fledged Interest Free Banking Business in Ethiopia" by Mohammed Ibrahim (2019) examines the development of interest-free banking in Ethiopia. Ibrahim highlights the demand for interest-free banking products in the country, particularly among the Muslim community. Initially, there were no full-fledged interest-free banks in Ethiopia, but the situation changed with the introduction of new directives. The article concludes by discussing the

need to amend existing legal provisions and suggests limiting the number of authorizations for interest-free banking businesses to ensure their success. General, the article provides valuable insights into the progress and challenges of interest-free banking in Ethiopia.

In other study by Suadıq Mehammed Hailu, Ömer Faruk Tekdoğan (2023) found that Islamic finance has gained attention as an alternative financial system adhering to Shariah principles. In Ethiopia, Islamic finance was introduced in 2011 through interest-free banking windows and full-fledged interest-free banks in 2019. However, the absence of a specific Shariah governance framework in the National Bank of Ethiopia's legislation raises concerns about compliance with Shariah principles. This literature review emphasizes the importance of Shariah compliance in Islamic finance and proposes solutions. A centralized Shariah advisory committee under the NBE and adapting international standards, such as those by Accounting and Auditing Organization for Islamic Financial Institutions AAOIFI, are recommended. Stakeholder involvement, including government, Islamic financial institutions, religious scholars, and professional associations, is crucial. Establishing a robust Shariah governance framework is essential for ensuring compliance and fostering the growth of Islamic finance in Ethiopia.

This study conducted by Debebe Alemu Kebede (2021) this study is to evaluate customer awareness and satisfaction regarding interest-free banking in Ethiopia and its impact on economic development. The findings of the study indicate low customer awareness of interest-free banking services, except among interest-free banking account holders. However, the majority of account holders are satisfied with the current services provided. The study suggests that interest-free banking can serve as an alternative banking channel, contribute to economic development by mobilizing and allocating monetary resources, creating employment opportunities, supporting GDP growth, and stabilizing crises and inflation. The study emphasizes the need for aggressive promotion of interest-free banking to attract customers beyond the Muslim community. It also recommends government support and emphasis on enabling interest-free banking services to stabilize economic crises and control inflation.

In a study conducted by Abate (2016), the Ethiopian interest-free banking regulation was evaluated in comparison to global Islamic finance standards. The study concluded that relying solely on the existing proclamation No. SBB/51/2011, which is limited and lacking in detail, poses a challenge for governing interest-free banking services. Abate recommended that the

National Bank of Ethiopia (NBE) develop a comprehensive directive to ensure the smooth implementation of the interest-free banking system. This directive would provide a more robust legal framework and guidance for the effective operation of interest-free banking in Ethiopia.

An article titled "The potential critical success factors of full-fledged interest-free banks in Ethiopia" by Abdulkadir Wahab Aman, Abdu Seid Ali, and Abdurahman Jemal Yesuf examines the potential critical success factors of full-fledged interest-free banks (IFBs) in Ethiopia. It emphasizes the importance of IFBs in enhancing financial inclusion and highlights the unique factors that contribute to their success or failure. The study identifies key factors such as legal and regulatory framework, management skills, reputation, product innovation, Shariah compliance, and competition from existing banks. The findings suggest the need for regulatory intervention and specific guidelines to support the growth of IFBs in Ethiopia

- The literature review provides an overview of various studies focusing on Islamic banking and finance in Ethiopia and other countries. It covers various aspects such as the historical development of Islamic banking, challenges faced by the industry, regulatory frameworks, compliance with Shariah principles, prospects, and opportunities for growth. The studies emphasize the potential benefits of Islamic banking, including financial inclusion, economic development, and customer satisfaction.

However, the knowledge gap identified in this review is the absence of a study that specifically evaluates the implementation and impact of interest-free banking in Ethiopia after the introduction of Directive No. SBB/72/2019 not. While existing studies provide understandings into the general challenges and opportunities of Islamic banking in the country and the studies are made before Islamic bank commence in the country, there is a need for a study that specifically examines the unique challenges and prospects faced by interest-free Banks. Such a study would consider factors such as the bank's market positioning, competition from existing banks, customer awareness and satisfaction, regulatory framework, management skills, and Shariah compliance, among other. This study aims to fill this gap by evaluating customer awareness and satisfaction regarding interest-free banking in Ethiopia and assessing its impact on economic development.

Therefore, the unique contribution of the proposed study on the challenges and prospects of interest-free banking in the case of Hijra Bank would be to provide a detailed analysis of the specific challenges and opportunities faced by the bank in the Ethiopian context. This study would help fill the gap in the existing literature by offering empirical evidence and insights specific to Hijra Bank's operations, addressing the knowledge gap and providing a more comprehensive understanding of the challenges and prospects of interest-free banking in Ethiopia.

The unique contribution of this study lies in its empirical evaluation of customer awareness and satisfaction, which provides insights into the effectiveness of interest-free banking services in Ethiopia. Additionally, it examines the impact of interest-free banking on economic development, including factors such as resource mobilization, employment generation, GDP growth, and crisis stabilization. By addressing these research gaps, the study aims to provide valuable evidence-based insights for policymakers, banking institutions, and researchers interested in the implementation and impact of interest-free banking in Ethiopia.

CHAPTER THREE

3. RESEARCH METHODOLOGY

3.1. Introduction

This research was design to assess the challenges & Prospects of interest-free banking services in Ethiopia. The chapter covers the research methods, designs, and tools that were applied to collect and analyze the data, methods of data collection and procedures, data analysis techniques, data sources, and instruments, target population, sampling procedure, and variable definition and model specification with the highlights of the data analysis and presentation methods.

3.2. Research Approach

According to Kothari (2004), research design constitutes the blueprint for the collection, measurement, and analysis of data. In line with this, Creswell (2009) identifies three primary research approaches: Qualitative, Quantitative, and Mixed Approach.

Kothari (2004) further elaborates on the quantitative approach, stating that it involves the generation of data in quantitative form, which can then be subjected to rigorous quantitative analysis. This approach can be sub-classified into inferential, experimental, and simulation approaches to research. The purpose of the inferential approach is to form a database from which to infer the characteristics or relationships of a population. This often involves survey research, where a sample of the population is studied (questioned or observed) to determine its characteristics, and then inferences are drawn about the population.

On the other hand, the qualitative approach to research is concerned with the subjective assessment of attitudes, opinions, and behaviors. This approach generates results either in non-quantitative form or in a form that is not subjected to rigorous quantitative analysis. Qualitative methods include focus group interviews, projective techniques, and depth interviews (Dawson, 2003).

Creswell (2009, p. 4) defines the Mixed Approach as "an approach to inquiry that combines or associates both qualitative and quantitative forms." Considering the purpose of this study on the prospects and challenges of interest-free banking (IFB) in Ethiopia, the researcher has adopted a Mixed Approach, utilizing both interview and questionnaire techniques for data collection.

3.3. Research Design

The research design refers to the method and procedures employed for collecting and analyzing the required data (John, 2007). The choice of research design is dependent on the objectives the researcher aims to achieve or the research questions they seek to answer.

According to Kothari (2004), descriptive research design, which includes surveys and fact-finding enquiries, is primarily focused on describing the current state of affairs. Considering the objectives of this study, which are to describe the views of respondents regarding the challenges and prospects of interest-free banking (IFB) in Ethiopia, the researcher has adopted a descriptive research design.

The descriptive research approach is well-suited for the purpose of this study, as it allows the researcher to gather comprehensive information about the current perceptions, experiences, and attitudes of both bank employees and customers towards full-fledged IFB. This design enables the researcher to provide a detailed and refined understanding of the full-fledged IFB landscape

in Ethiopia, which is crucial for identifying the key challenges and prospects of this financial model.

By employing a descriptive research design, the researcher can gather data through various methods, such as surveys, interviews, and observations, to gain insights into the respondents' perspectives on the advantages, disadvantages, and potential areas for improvement in the full-fledged IFB sector. This approach facilitates the development of a thorough and contextual understanding of the topic, which is essential for formulating meaningful recommendations and strategies to enhance the growth and sustainability of full-fledged IFB in the Ethiopian financial system.

3.4. Research Methodology

The study employed a mixed methods approach, combining quantitative and qualitative data collection and analysis, to answer the following research questions related to challenge and prospect of full-fledged interest free banks. Quantitative data was collected from the bank's financial statements. Qualitative data was gathered through mixed approach consisting both interview and questioners' techniques for data collection.

3.5. Population, Sampling Techniques and Sample Size

3.5.1. Target population

According to the National Bank of Ethiopia, currently 31 banks are licensed to operate in the Ethiopian banking industry. This includes one development bank (DBE), 23 private commercial banks, one cooperative bank, one government bank, one mortgage bank, and four full-fledged interest-free banks. The target population of the study comprises these four full-fledged interest-free banks.

Hijra Bank has 60 branches in Ethiopia, with 18 located in Addis Ababa. To make the research manageable, the study was focus on 5 branches with the largest deposit and customer base.

The pilot study identified four full-fledged interest-free banks in Ethiopia: Hijra, Zemzem, Shebele, and Ramis. However, only Hijra Bank was included in this study. Zemzem was excluded due to lack of data; while Shebele and Ramis were excluded as they are newly established, having commenced operations in 2023.

The decision to exclude Zemzem, Shebele, and Ramis is based on their limited data availability and recent establishment, which may limit their ability to provide meaningful insights into the challenges and prospects of interest-free banking in Ethiopia. Therefore, the focus of the study is on the more established Hijra Bank, which can provide comprehensive and reliable information for the research objectives.

Purposive sampling is used to select the research units, excluding banks with less than 3 years of experience in the full-fledged interest-free banking industry.

3.5.2. Sampling techniques

The study population is customers and employees of Hijra Bank who use products of and work at the bank respectively which are located in Addis Ababa city. Questionnaires distributed for those employee's sample branches and customers of the bank. This study used multistage sampling techniques-probability and non-probability to reach at the specific respondents. A purposive sampling selecting procedure applied to represent the population of --- branches, in which to select sample branch simple random sampling are applied. The major reason for selecting simple random sampling is that it represents the population, in which each branches has an equal probability of being selected.

3.5.3. Sampling Size Determination

The target population for this study comprises employees and customers of Hijra Bank branches located in Addis Ababa, Ethiopia. To select the sample, a multistage sampling technique was employed. First, five Hijra Bank branches with the largest deposit and customer base in Addis Ababa were purposively selected. Then, respondents, including both customers and staff, were drawn from these selected branches. This approach ensures representation from branches with significant activity, while aiming to provide each member of the selected population a fair chance of participation.

To estimate the required sample size, Cochran's formula for sample size determination was used, which is appropriate for studies involving large populations:

$$n = \frac{Z^2 * p * q}{e^2} = \frac{1.96^2 * 0.5 * 0.5}{0.05^2} \approx 385$$

Where:

- n is the sample size,
- Z is the Z-value (1.96 for 95% confidence level),
- p is the estimated proportion of the population (0.5 is used for maximum sample size),
- e is the margin of error (0.05 is typical).

3.6. Data Collection Techniques and Procedures

3.6.1. Data source

This study utilized both primary and secondary sources of data to ensure comprehensive analysis. Primary data were collected through a new survey specifically designed for this research, targeting various stakeholders relevant to the study.

The primary data collection instrument was a structured questionnaire, which is a carefully designed set of questions intended to elicit reliable and valid responses from a selected sample (Hussey & Hussey, 1997). The questionnaire was administered to employees and customers of Hijra Bank to gather their perceptions on the challenges and prospects of full-fledged interest-free banking.

Secondary data were sourced from existing information previously collected for other research purposes (Adams, Khan, Raeside, & White, 2007). These included journal articles, prior postgraduate research, bank reports, internal documents, and web-based resources, especially from academic databases such as Google Scholar. The secondary data helped provide a broader context and supported the analysis of the primary findings.

3.4.4.2 Data collection instruments

The researcher adapted and modified a questionnaire from a previous study by Mohammed (2012). The questionnaire consisted of structured questions using a 3-point Likert scale (Agree, Neutral, Disagree) to measure respondents' perceptions. To improve the response rate, a cover letter was provided explaining the purpose of the research, its importance, why the participants were selected, and ensuring confidentiality. The questionnaire was divided into four parts: the first collected respondents' personal information; the second assessed the prospects of Islamic banking; the third included close-ended questions to measure demand for interest-free banking services from customers and employees; and the fourth evaluated challenges in implementing full-fledged interest-free banking. In addition to the questionnaire, face-to-face interviews with

bank officials were conducted to gain deeper insights, despite being time-consuming. The researcher personally managed data collection to ensure respondent comfort and support. Permission was obtained from branch managers and individual respondents before distributing the questionnaire.

To complement the primary data, secondary data on Hijra Bank's financial performance from 2022 to 2024 was collected and analyzed. This data provided valuable insights into the bank's operational trends, financial health, and growth prospects. The analysis revealed that total assets increased significantly over the period, as did interest-free deposits and the number of deposit customers, indicating growing public trust and market acceptance. The number of mobile banking customers also rose substantially, reflecting increasing digital adoption. Loan disbursements, particularly Murabaha financing, expanded markedly with strong contributions from trade, construction, and industry sectors. Financial performance improved from a net loss in 2022 to a net profit in 2024, demonstrating effective revenue enhancement and cost management. Efficiency measures such as Return on Assets and operating expense ratios also showed positive trends. This secondary data analysis supported the study's findings on both the prospects and challenges of interest-free banking services in Ethiopia.

3.7. Data Analysis Techniques

Both quantitative and qualitative data analysis methods were employed. Quantitative data collected from the structured questionnaires were coded and analyzed using the Statistical Package for Social Sciences (SPSS) version 26. Descriptive statistics such as frequencies, percentages, and median values were calculated and presented in tables and graphs to facilitate clear understanding and interpretation. Qualitative data from interviews were collected through written notes and audio recordings. These raw data were summarized and interpreted narratively, linking the insights to the study's main objectives. Qualitative analysis also served to triangulate and validate the findings obtained from the questionnaire's close-ended questions. The incorporation of secondary data analysis of Hijra Bank's financial performance further enriched the study by providing an empirical foundation to complement primary data insights.

3.8. Ethical Consideration

Ethical conduct states that it is the responsibility of the researcher to assess carefully the possibility of harm to research participants, and to the extent that it is possible, the possibility of

harm should be minimized (Bryman& Bell, 2007). During the data collection and interpretation processes, the researcher convinced the participants that any confidential information they disclose was keep confidential and convince them the important of the study is to help the bank and the employees. The respondents also informed, the exercise is only for academic purposes and that confidentially is assured and no one would fall a victim because of any adverse findings in connection with their professional duties. This is done in order to motivate them to give their responses without reservation. Every questionnaire attached to a cover letter which clearly explained the purpose of the survey. The questionnaire didn't require the names of the respondents; this was be to protect their identity and remain anonymous. As a result, the employees are aware from the beginning what the researcher doing, why and where the information going and why it gathered.

CHAPTER FOUR

4. DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1. Introduction

The chapter presents the findings, analysis, and interpretation of the data collected to examine the potential and challenges of interest-free banking services in Ethiopia, focusing specifically on Hijra Bank. The analysis blends qualitative and quantitative data collected from primary and secondary sources to provide a comprehensive understanding of the subject.

Structured questionnaires were used to collect primary data on Hijra Bank's customers and staff, along with in-depth interviews on key staff, including managers and Shariah advisors. The

instruments were designed to study institutional capacity, customer awareness, regulatory body support, operational difficulties, and growth areas of interest-free banking.

Secondary data were gathered from various official reports, including pertinent directives published by the National Bank of Ethiopia, Hijra Bank's internal annual reports, performance assessments, and strategic documents. Precisely, the analysis includes a recap of the bank's financial and operational performance over the past three years, providing important information regarding the developmental progress of the institution, challenges encountered, and areas with development potential. Additionally, comparative analyses of Islamic finance activities in international and regional contexts were called up to contextualize the findings.

The chapter begins by giving an outline of the demographic characteristics of the respondents before systematically laying out the major findings under main thematic headings. These are public awareness level, operating and regulation problems, competitiveness, and strategic prospects for expanding interest-free banking in Ethiopia.

4.2. Response Rate of Respondents

Data collection for the study was conducted through the usage of both semi-structured interviews and structured questionnaires. 384 questionnaires were distributed to Hijra Bank employees and customers who were randomly selected from various departments and branches. The questionnaires were filled and returned and yielded a 100% response rate. This is desirable because the high response rate enhances the credibility and generalizability of the findings to the target population.

In addition to the questionnaire survey, qualitative information was collected by means of key informant interviews for an in-depth understanding of the interest-free banking institutional and operational dynamics. Six individuals were selected by adopting a purposive sampling technique. These individuals were branch managers, Shariah compliance officers, and senior employees directly concerned with the provision and management of interest-free banking products of Hijra Bank. The interviews provided us with useful insights on the operational issues, regulatory matters, attitudes towards the market, and strategic opportunities concerned with the evolution of Islamic banking in Ethiopia.

4.3. Demographic Information of Respondents

Understanding the demographic profile of respondents is essential in identifying how various social, educational, and occupational backgrounds influence perceptions and experiences with interest-free banking. This section provides a detailed analysis of respondents' gender, educational level, occupation, duration of using Islamic banking services, and tenure at Hijra Bank.

4.3.1. Gender

According to Table 4.1, among 384 respondents, 197 (51.30%) were women and 187 (48.70%) were men. The nearly even gender distribution suggests equally balanced views, crucial to the determination of acceptability and inclusiveness of interest-free banking facilities. The equally more proportionate number of female respondents may suggest more interest and confidence from women in Sharia-compliant banking, perhaps showing the Islamic banking contribution to women's inclusion in Ethiopian finance.

4.3.2. Educational Level

The respondents enjoyed different educational levels. Postgraduates accounted for 81 individuals (21.09%), seconded by the non-formally educated and primary-educated, both at 20.57% (79 each). Higher education accounted for 74 respondents (19.27%), while secondary education accounted for 71 (18.49%). This variation indicates that interest-free banking in Hijra Bank has an attraction across formally educated and lesser-educated individuals. It also specifies the necessity for tailor-made awareness programs to improve financial literacy, especially among customers lacking a formal education who might be limited in understanding Islamic finance principles.

4.3.3. Occupation

The occupational breakdown of the respondents shows that the majority were retirees (22.66%), followed by entrepreneurs (20.83%), workers and students (both 19.53%), and the unemployed (17.45%). The large number of business entrepreneurs and retired clients utilizing Hijra Bank implies that Islamic banking instruments such as Murabaha and Mudaraba may be particularly desirable as retirement funds and investment money. The confluence of income and dependent-economic backgrounds results in Hijra Bank having a large population of customers, and

therefore, this is a critical consideration in assessing the penetration of the market and the availability of service.

4.3.4. Duration of Using Islamic Banking

Out of the 384 individuals interviewed, 107 (27.86%) had been using the services of Islamic banking for more than three years, 100 (26.04%) for 6 to 12 months, 92 (23.96%) for less than six months, and 85 (22.14%) for 1 to 3 years. The figures show that most users are fairly new to interest-free banking, which is in line with growing uptake and use of Sharia-friendly services. Without doubt, the presence of long-term users is a sign of customer satisfaction and retention. Understanding the experiences of new and long-term clients helps determine the efficiency and sustainability of Islamic banking services at Hijra Bank.

4.3.5. Duration of Working at Hijra Bank

Among 75 employee participants, 25 (33.33%) had more than three years of service, 21 (28.00%) had service of 6 to 12 months, 18 (24.00%) had service with experience of 1 to 3 years, and 11 (14.67%) had service of less than 6 months. The almost equitable division indicates that the bank includes experienced workers as well as new workers. This diversity is significant in analyzing internal perceptions of institutional challenges and opportunities, including staff training, customer handling, and compliance with Islamic financial principles.

Table 4.1: Descriptive Summary of Demographic variables

Category	Subcategory	Frequency	Percent
Gender	Female	197	51.30%
	Male	187	48.70%
	Total	384	100.00%
Educational Level	Higher Education	74	19.27%
	No Formal Education	79	20.57%
	Postgraduate	81	21.09%
	Primary	79	20.57%
	Secondary	71	18.49%
	Total	384	100.00%
Occupation	Business Owner	80	20.83%
	Employee	75	19.53%
	Retired	87	22.66%
	Student	75	19.53%
	Unemployed	67	17.45%

	Total	384	100.00%
Duration Using Islamic Banking	1-3 years	85	22.14%
	6-12 months	100	26.04%
	Less than 6 months	92	23.96%
	More than 3 years	107	27.86%
	Total	384	100.00%
Duration Working at Hijera Bank	1-3 years	18	24.00%
	6-12 months	21	28.00%
	Less than 6 months	11	14.67%
	More than 3 years	25	33.33%
	Total	75	100.00%

4.4. Prospects of Interest-Free Banking Services in Ethiopia

The results in Table 4.2 capture very critical comments on the perceived potential of interest-free banking (IFB) to expand and develop in Ethiopia. The grand mean score of 3.03 and standard deviation of 1.40 indicate that most of the respondents had a generally positive perception regarding the expansion and development potential of Islamic banking. This is complemented by the increased visibility and participation of Islamic financial institutions like Hijra Bank in Ethiopia's banking industry.

A considerable majority of the respondents agreed that demand for Sharia-compliant products and services is growing in Ethiopia with a mean value of 3.04. This affirms market trend identified by Mohammed and Yimer (2021), who observed evidence that awareness and acceptability for Islamic banking is on the rise among Ethiopia's urban and semi-urban residents. This also presents a chance for institutions like Hijra Bank to deepen their market penetration through products that address customers' religious and moral longings.

The respondents' rating of the regulatory environment, in terms of a mean score of 3.03, was divided. Some felt that existing legal regulations were useful, while others were not aware or were dissatisfied. This uncertainty is an indication of Getachew and Ahmed's (2022) concern that although Ethiopia has evolved to allow guidelines for allowing interest-free windows within banks, the regulatory framework is yet to mature so much as to allow a full legal framework for genuine Islamic banks. This emphasizes the importance of clearer and enabling regulations so as to stimulate innovation and access within the industry.

Regarding the prevalence of human capital with the required skills, the lowest mean value (2.97) was indicated by respondents, reflecting an extensive problem of an insufficiency of proper experts in Islamic finance. This was also noted in Abubakar and Ibrahim's (2021) study, quoting the lack of knowledge in Sharia-compliant finance to continue influencing effectiveness in operations and customer services in most Islamic financial institutions in Ethiopia. This lacuna needs to be filled through mainstream training and certification courses to accommodate the sustainable growth of the sector.

Under the collaboration potential, a mean score of 3.14 was recorded with the assertion that Islamic and conventional bank collaboration would unlock new market opportunities. This is a positive view shared by Hassen and Mohammed (2023), who asserted that traditional and Islamic bank strategic alliances and partnerships in African markets have enhanced product diversification, innovation, and sharing of resources, all translating to greater financial inclusion.

In terms of the contribution of technology to Islamic banking access, the mean score was 2.99. While there were respondents who recognized respondents who appreciated the revolutionary nature of the role that digital platforms played, others were uncertain, perhaps because of existing shortcomings in digital delivery. This is also supported by a study conducted by Tsegaye (2022), which observed that even as products of mobile and internet banking have increased in number throughout Ethiopia, their usage by Islamic banks is still low as they are not highly convergent with Sharia-compliant systems and nor are they widely known by the public.

In general, the report shows that while future potential for interest-free banking in Ethiopia is auspicious, the most critical challenges such as regulatory challenges, human resources shortages, and technological adjustment need to be addressed. However, rising demands from people and inter-institutional cooperation avenues provide tremendous scopes for the future development and stabilization of Islamic banking operations in the country.

Despite promising development opportunities based on growing public demand, possible alliances, and increasing awareness, interest-free banking services in Ethiopia are confronted with real challenges such as regulatory uncertainty, lack of human capital with necessary skills, and slow technology uptake that need to be overcome to attain stable development and stability of institutions such as Hijra Bank.

Table 4.2: Descriptive statistics of Prospects of Islamic Banking (IFB) in Ethiopia

Question	Strongly Disagree (%)	Disagree (%)	Neutral (%)	Agree (%)	Strongly Agree (%)	Mean	Std. Dev.
The demand for Sharia-compliant financial products and services is growing in Ethiopia, presenting a significant opportunity for expansion.	20.3	17.2	21.4	20.3	20.8	3.04	1.42
The existing regulatory frameworks in Ethiopia adequately support the growth and innovation of Islamic banking products.	18.8	19.3	23.2	17.7	21.1	3.03	1.40
There is a sufficient pool of qualified human resources with expertise in Islamic finance within Ethiopia.	20.3	22.9	17.7	18.0	21.1	2.97	1.44
Collaboration between existing Islamic banks and traditional banks in Ethiopia can unlock new market opportunities.	15.9	17.2	22.4	25.8	18.8	3.14	1.34
Technological advancements like mobile banking have the potential to increase access to Islamic banking services in Ethiopia.	18.5	21.6	20.8	20.8	18.2	2.99	1.38
Aggregate mean and Std. Dev						3.03	1.40

Source: Own Survey Compiled Using SPSS, 2025

4.5. Potential Impacts of Full-Fledged Islamic Banking

The primary aim of this study is to investigate potential impacts of authentic Islamic banking on the economy and financial system of Ethiopia. Respondents' perceptions are presented in numbers as reported in Table 4.3. Overall, the results show a positive perception of what Islamic banking can contribute towards financial inclusion, stability and growth of sectors.

Most of the participants (41.7% total "Agree" 20.3% and "Strongly Agree" 21.4%) expressed that the application of full-fledged Islamic banking would bring unbanked Ethiopians into the banking system who are ready to utilize Sharia-compliant financial products, and this is beneficial for greater financial inclusion. This is reiterated with a mean score of 3.06 (SD = 1.43) showing moderate agreement on this statement. This aligns with Yimer and Abdulahi (2021),

who note the possibility of Islamic banking to penetrate hitherto unbanked segments of society using ethically correct financial products.

In regard to the financial system's stability and ethics, they saw that 39.1% of the survey respondents answered in agreement (16.4%) or strong agreement (22.7%) that the Islamic financing maxims of risk- and profit-sharing would result in a more ethical and stable banking system in Ethiopia. The mean response to this question was 2.95 (SD = 1.49), which reflects moderate agreement but disagreement or neutrality to some extent, reflecting an ongoing need for education and awareness. Abubakar and Ibrahim (2021) further maintain that these principles are useful to financial sector resilience.

The idea of Islamic banking realizing new investment prospects in key sectors like infrastructure and agriculture was fairly evident, where 38.5% of the respondents assented or strongly assented. The statement was found to have a mean of 2.99 (SD = 1.40). The result confirms the work of Getachew and Ahmed (2022) that Islamic finance can diversify Ethiopia's investment portfolio and fund development dreams.

Competition implications were hedged with more uncertainty, with 36.5% accepting or strongly accepting that widespread Islamic banking would boost sector competition to the advantage of customers. This is in line with a general mean score of 2.95 (SD = 1.36), and reflects some doubt as to the net market effect. Finally, the participants indicated the need for regulatory adaptability because 39.8% of them agreed or strongly agreed that the financial sector in Ethiopia must undergo significant regulatory adjustments to accommodate Islamic banking's unique operational features (mean = 2.99, SD = 1.44). Mohammed and Tesfaye (2023) recognize this as one of the pressing policy reform areas to ensure successful integration.

Overall, the Islamic banking effects' grand mean of 2.99 (SD = 1.42) is indicative of conservative optimism on the stakeholders' part. The results highlight the potential strengths and pitfalls of adopting a full-fledged Islamic banking system in Ethiopia, as per recent research in calling for supportive policies and increased public awareness.

The research finds that while its potential to increase financial inclusion, stability of economies, and investment diversification in Ethiopia is extremely high, success for Islamic banking is subject to overcoming the regulatory hurdles, awareness creation among the general populace,

and institutional settings restructuring to the unique requirements of interest-free banking products.

Table 4.3: Descriptive statistics of Impacts of Full-fledged Islamic Banking on the Ethiopian Economy and Financial System

Question	Strongly Disagree (%)	Disagree (%)	Neutral (%)	Agree (%)	Strongly Agree (%)	Mean	Std. Dev.
The introduction of full-fledged Islamic banking could promote financial inclusion by attracting unbanked Ethiopians seeking Sharia-compliant financial products.	19.8	18.0	20.6	20.3	21.4	3.06	1.43
Islamic financing principles, emphasizing profit-sharing and risk-sharing, could contribute to a more stable and ethical financial system in Ethiopia.	24.5	17.5	19.0	16.4	22.7	2.95	1.49
The growth of Islamic banking could potentially unlock new investment opportunities in sectors like infrastructure and agriculture in Ethiopia.	20.6	17.2	23.7	19.5	19.0	2.99	1.40
Full-fledged Islamic banking might lead to increased competition within the Ethiopian financial sector, potentially benefiting customers through better products and lower fees.	18.8	21.1	23.7	19.3	17.2	2.95	1.36
The Ethiopian financial system may require significant regulatory adjustments to accommodate the unique aspects of Islamic banking operations.	19.8	22.7	17.7	18.2	21.6	2.99	1.44
Aggregate mean and Std. Dev						2.99	1.42

Source: Own Survey Compiled Using SPSS, 2025

4.6. Financial Inclusion Through Islamic Banking in Ethiopia

The second objective of this study was to analyze the likely barriers and also opportunities of enhancing financial inclusion through Islamic banking in Ethiopia. Financial inclusion remains a priority agenda of Ethiopia to bring the unbanked and underbanked segment into the formal financial sector. Islamic banking, with its characteristic profit-sharing structure and Sharia-

compliant financial products, presents a feasible way to circumvent some of the challenges for sections of the population who avoid mainstream interest-based banking due to religious reasons.

Table 4.4's descriptive statistics capture respondents' views regarding Islamic banking's role in enhancing financial inclusion. More than half of the respondents concurred or strongly concurred that emphasis on profit-sharing would render financial products readily accessible to Ethiopians who are concerned about interest (mean = 3.01, SD = 1.38). Similarly, Islamic financial products like Musharaka that allow financing under partnership were viewed as favorable to facilitate small business to access credit with ease (mean = 3.03, SD = 1.43).

Second, the respondents identified that expansion of Islamic banking services would help increase more of Ethiopia's unbanked to be covered by the formal financial system (mean = 3.10, SD = 1.46). Conversely, among the key challenges identified is the lack of awareness and knowledge of the concept of Islamic banking, which was undermine its ability to create more financial inclusion (mean = 3.15, SD = 1.40). This emphasizes the pressing demand for public education and awareness programs on Islamic finance.

In addition, the potential for alliance between Islamic banks and existing microfinance institutions was put across as a viable option for developing innovative financial products reliant on the need of unbanked Ethiopians (mean = 2.99, SD = 1.45). Overall, the grand mean of 3.05 (SD = 1.42) suggests an overwhelmingly positive attitude toward the contribution of Islamic banking in bringing about financial inclusion, moderated by sensitivity to the magnitude of education and operational complexities.

These findings are consistent with recent studies emphasizing the significance of special financial products and co-operation in tackling effectively financially excluded groups in Ethiopia (Gebremariam & Assefa, 2021; Tadesse & Mohammed, 2022). Furthermore, the challenges mentioned here highlight the need for collective action to inform the public on Islamic finance, an element which has been noted in other emerging market environments as key to effective financial inclusion activities (Kassim & Anwar, 2023).

The results accentuate that while Islamic banking holds a promising potential to significantly enhance the financial inclusion of Ethiopia, tackling problems such as deficiency of public

awareness and the need for strategic partnerships is still pivotal to its viable expansion under the broader umbrella of interest-free banking facilities.

Table 4.4: Descriptive statistics of Financial Inclusion and Islamic Banking

Question	Strongly Disagree (%)	Disagree (%)	Neutral (%)	Agree (%)	Strongly Agree (%)	Mean	Std. Dev.
The emphasis on profit-sharing in Islamic banking could make financial products more accessible for Ethiopians with religious reservations about interest.	19.3	19.8	19.0	24.7	17.2	3.01	1.38
Islamic banking products designed for banks, like Musharaka, could increase access to financing for small businesses run by Ethiopians.	20.1	19.3	20.1	19.3	21.4	3.03	1.43
The wider availability of Islamic banking services could potentially encourage a larger portion of the unbanked population in Ethiopia to participate in the formal financial system.	20.8	15.4	21.1	18.8	24.0	3.10	1.46
Lack of awareness and financial literacy about Islamic banking principles might hinder its effectiveness in promoting financial inclusion in Ethiopia.	16.2	19.0	22.4	18.8	23.7	3.15	1.40
Collaboration between Islamic banks and existing microfinance institutions could create innovative financial products tailored to the needs of unbanked Ethiopians.	23.7	13.3	23.7	19.0	20.3	2.99	1.45
Aggregate mean and Std. Dev						3.05	1.42

Source: Own Survey Compiled Using SPSS, 2025

4.7. Customer Perceptions and Attitudes towards Islamic Banking

The third objective of the study was to assess the attitude and perception of the potential customers of Islamic banking in Ethiopia, and more particularly with respect to Hijera Bank. The findings illustrate a favorable perception of the respondents with regard to the credibility and

ethical foundations of the Islamic bank products offered by Hijera Bank. The majority of the respondents agreed that Islamic banking is a trustworthy substitute for traditional banking (51.56%), and an equal number of them was positively inclined towards the use of these types of services (50.26%). Furthermore, 51.82% were of the view that Hijera Bank Islamic products serve their financial needs more than traditional products, whilst half of the sample (50%) was content with the moral aspect of Islamic banking. Further, a large majority (52.08%) preferred Islamic banking services over conventional ones based on ethical grounds. These results reflect the positive inclination of customers towards Islamic banking in Hijera Bank, indicating its potential for expansion in the sector.

The results reveal that building more trust and positive attitude towards Islamic banking hold high potential for the development of interest-free banking in Ethiopia, despite the continuing issues related to awareness about products and availability of services.

Table 4.5: Descriptive statistics of Perceptions and Attitudes Toward Islamic Banking

Question	No (%)	Yes (%)
I believe Islamic banking at Hijera Bank is a trustworthy alternative to conventional banking.	48.44	51.56
I have a positive attitude towards using Islamic banking services at Hijera Bank.	49.74	50.26
Islamic banking products at Hijera Bank meet my financial needs more effectively than conventional banking.	48.18	51.82
I am satisfied with the ethical approach of Islamic banking at Hijera Bank.	50.00	50.00
I would prefer Islamic banking services at Hijera Bank over conventional ones for ethical reasons.	47.92	

Source: Own Survey Compiled Using SPSS, 2025

4.8. Challenges Facing the Growth of Islamic Banking in Hijera Bank

The fourth objective of this ongoing study was to assess issues to Islamic banking expansion and growth, especially at Hijera Bank. Findings show different fundamental issues that must be addressed to enable sustainable growth.

Among the greatest challenges identified is the fact that not much public awareness and understanding exist about the principles of Islamic banking. Approximately 35.7% of the

respondents strongly agreed or agreed that ignorance was a principal hindrance to increased adoption (Mean = 2.90, SD = 1.40). This is in agreement with existing research that states low knowledge and misconceptions regarding Islamic finance are reasons that are slowing down market penetration, particularly in developing nations like Ethiopia (Khan & Shah, 2021; Al-Swidi et al., 2022).

Another important problem is the underdevelopment of the infrastructure of the Islamic financial market of Ethiopia, i.e., the absence of necessary instruments like Sukuk (Islamic bonds) and Takaful (Islamic insurance). The research found that 44.9% of the respondents had referred to this shortage as a weakness hindering the depth and competitiveness of Islamic banking products (Mean = 3.10, SD = 1.48). Similar problems have been experienced in sub-Saharan Africa, where the deficit of products is constraining customer choice and slowing sector development (Mohamed et al., 2023).

Islamic window competition with conventional banks is also a substantial challenge because 41.2% of the participants considered it as a major challenge (Mean = 2.97, SD = 1.43). Islamic windows are niche Islamic banking solutions for conventional banks—can erode the market share of specialized Islamic banks through restricted yet accessible Islamic financial solutions (Zainal & Abdullah, 2021).

Regulatory limitations were also identified to be a major hindrance. The following difficulties were cited by the respondents: an unpropitious setting to regulation, hence making it difficult for them to innovate product and operate at an effective level (43.0% agreement; Mean = 3.04, SD = 1.44). They agree with recent studies that had found the current financial regulatory system of Ethiopia to be devoid of inclusive guidelines particularly relevant to Islamic banking's contracted and specialized designs (Ahmed & Mustafa, 2022).

Finally, the recruitment and retention of great Shariah experts and Islamic finance experts are a persistent issue, with 37.5% of the participants agreeing (Mean = 2.93, SD = 1.43). The lack of skills impairs the ability of Islamic banks to strictly comply with Shariah guidelines and create innovative competitive products (Omar et al., 2021).

Generally, the total mean score of 2.99 shows a high but moderate level of problems that hinder Islamic banking development at Hijera Bank. Such hindrances should be addressed through

collective efforts that include public campaigns, regulatory changes, infrastructure, and human capital investment.

These findings reveal that even though there is great scope for interest-free banking in Ethiopia, it is constrained by awareness gaps, infrastructure, regulatory disadvantages, and skill shortages which have to be overcome systematically.

Table 4.6: Descriptive statistics of Challenges in the Growth of Islamic Banking

Question	Strongly Disagree (%)	Disagree (%)	Neutral (%)	Agree (%)	Strongly Agree (%)	Mean	Std. Dev.
Limited public awareness and understanding of Islamic banking principles create a barrier for existing Islamic banks in Ethiopia.	21.6	20.8	21.9	17.5	18.2	2.90	1.40
The lack of a well-developed Islamic financial market (Sukuk, Takaful) hinders the product offerings of existing Islamic banks.	21.9	14.6	18.5	21.4	23.7	3.10	1.48
Competition from conventional banks offering Islamic windows poses a significant challenge for existing Islamic banks.	21.4	20.6	16.9	21.9	19.3	2.97	1.43
The current regulatory environment in Ethiopia presents challenges for the smooth operation and innovation of Islamic banking products.	21.1	17.7	18.2	22.1	20.8	3.04	1.44
Recruiting and retaining qualified Shariah scholars and Islamic finance professionals is a challenge for existing Islamic banks in Ethiopia.	20.3	24.2	18.0	17.2	20.3	2.93	1.43
Aggregate mean and Std. Dev						2.99	1.44

Source: Own Survey Compiled Using SPSS, 2025

4.9. Regulatory and cultural impact on Islamic Banking Development

The objective here was to further elucidate the cultural and regulatory impact on Islamic banking growth and adoption in Ethiopia. Table 4.7 provides descriptive statistics indicating respondents' perceptions of the manner in which Ethiopian culture appreciates and the regulatory environment impacts Islamic banking.

The findings indicate that they moderately believed Ethiopian cultural values based on ethical financial conduct would be receptive to Islamic banking activities overall (Mean = 2.93, SD = 1.44). It indicates that the belief of cultural congruence is held by the respondents but there is room for awareness raising to enhance it. As proof, current studies have pointed out that Islamic finance's moral orientation is attractive to values of the majority of African countries, e.g., Ethiopia (Ahmed & Mustafa, 2022).

With reference to the regulatory framework, the respondents were mildly positive to neutral regarding whether or not the current regulations are adequate to address the specific operational needs of Islamic banking institutions (Mean = 3.03, SD = 1.40). This is in accord with current policy issues in the literature whereby loopholes in the regulations pose a significant hindrance to full development of Islamic banking in the new markets (Mohamed, Yusuf, & Abdalla, 2023).

Public campaigns to promote Islamic banking concepts were found to be significant, with an average rating of 3.05 (SD = 1.37), indicating that raising public awareness could enhance acceptance. This is also followed by Al-Swidi, Saleh, and Husniyah (2022) in their study, where they emphasized that education has a positive impact on the adoption of Islamic financial products.

The religious leadership input was perceived to make a fairly modestly positive input (Mean = 2.90, SD = 1.44), suggesting that religious support is essential but was not be sufficient to tackle each growth obstacle in isolation. Khan and Shah (2021) also reasoned that there must be something religious leadership can do but that this would have to be complemented with broader money management schemes.

Finally, the question of compatibility of Islamic banking operations with existing Ethiopian finance regulations was raised as the stumbling block, as shown by a mean of 3.00 (SD = 1.44). This is affirmation of the persisting problem of balancing the traditional regulatory demands with the unique demands of Islamic finance, which has already been noted by Ahmed and Mustafa (2022) and Mohamed et al. (2023).

Overall, the mean value of 2.98 and standard deviation of 1.42 reflect moderate agreement on cultural and regulatory issues affecting Islamic banking prospects in Ethiopia and on needing some policy reforms and cultural training to support sector development.

The results identify that although cultural foundations in Ethiopia are rather positive, interest-free banking success has a high dependency on regulatory enhancement, cultural compatibility, and ongoing public enlightenment.

Table 4.7: Descriptive statistics of Cultural and Regulatory Impact on Islamic Banking

Question	Strongly Disagree (%)	Disagree (%)	Neutral (%)	Agree (%)	Strongly Agree (%)	Mean	Std. Dev.
Ethiopian cultural values emphasizing ethical financial practices would be receptive to the principles of Islamic banking.	22.7	19.0	21.6	16.2	20.6	2.93	1.44
The current regulatory framework in Ethiopia adequately addresses the specific needs and operations of Islamic banking institutions.	19.5	18.2	20.6	22.9	18.8	3.03	1.40
Public education initiatives promoting Islamic banking principles could significantly increase its acceptance among Ethiopians.	18.0	18.8	21.6	23.7	18.0	3.05	1.37
The involvement of religious leaders in promoting financial literacy and the benefits of Islamic banking could positively impact its prospects.	22.1	22.7	18.0	17.2	20.1	2.90	1.44
Potential concerns about the compatibility of Islamic banking practices with existing Ethiopian financial regulations create a barrier for its growth.	21.1	20.3	16.2	22.1	20.3	3.00	1.44
Aggregate mean and Std. Dev						2.98	1.42

Source: Own Survey Compiled Using SPSS, 2025

4.10. Human Resource Capacity in Ethiopian Islamic Banking

Human resource capability analysis of Hijera Bank brings forth some notable findings. The figures bear witness to a recognized lack of Islamic banking professionals, where a mean of 3.04 signifies that the majority of respondents agree this lack is a significant challenge. This shortage has immediate effects on the bank's ability to deliver Shariah-compliant financial services

effectively, a problem consistent with dominant research positing trained staff shortage as the most limiting factor to the growth of Islamic banking in developing economies (Ali & Muhammad, 2021).

Also, the mean of 2.84 for capacity-building activities in organizations shows the dominant perception that programs to build personnel in Islamic finance are not very effective. The high percentage of disagreement and strong disagreement among respondents that their organizations offer adequate training demonstrates a dire need for Hijera Bank to initiate more capacity-building initiatives. This need is also justified in literature, where it is indicated that good internal training policies are necessary to fill knowledge gaps and develop employee competencies (Hassan & Osman, 2022).

With respect to Shariah expertise, opinions were also divided, with a mean of 3.02 indicating a neutral to moderate view of the presence of Shariah expertise within organizations, i.e., Hijera Bank. But the extremely slim measure of disagreement indicates that it could lack ubiquity or be well entrenched in all operations, thus inhibiting the bank from innovating as well as being compliant. Robust Shariah governance is of the greatest significance to Islamic banks to gain credibility and customers' trust (Rahman et al., 2021).

Lastly, the results indicate strong agreement that more specialized training in Islamic banking is necessary with a mean of 3.03 and a large number of respondents agreeing that the development of employees' knowledge through ongoing education and certification is most important. For Hijera Bank, ongoing professional training investment, i.e., workshops and cooperation with Islamic finance institutions, was be significant to build the capacity of human resources and ensure sustainable development (Yusuf & Abdullahi, 2021).

On a general note, adjustment to these kinds of human resource challenges is essential to Hijera Bank and the overall Ethiopian Islamic banking sector to adapt to market demands and expand their services.

This note highlights that the development and sustainability of interest-free banking in Ethiopia are heavily reliant on addressing the critical shortage of experienced professionals and the development of institutional training capacity.

Table 4.8: Descriptive statistics of Human Resource Capacity

Question	Strongly Disagree (%)	Disagree (%)	Neutral (%)	Agree (%)	Strongly Agree (%)	Mean	Std. Dev.
There is a shortage of skilled professionals in Islamic banking in Ethiopia.	18.5	19.0	22.1	21.1	19.3	3.04	1.38
My institution provides enough capacity-building programs in Islamic finance.	25.3	17.7	21.1	20.1	15.9	2.84	1.42
Adequate expertise in Shariah compliance is available in our organization.	19.3	21.6	18.8	18.5	21.9	3.02	1.43
More specialized training is needed to improve staff knowledge in Islamic banking.	19.3	20.1	18.5	22.9	19.3	3.03	1.41
Aggregate mean and Std. Dev						2.98	1.41

Source: Own Survey Compiled Using SPSS, 2025

4.11. Market Dynamics and Competition

Market conditions and competition data suggest that Hijera Bank and the rest of the Islamic banks in Ethiopia operate under a competitive market structure. Most respondents agreed that Islamic banks face strong competition from traditional banks, as evidenced by a mean rating of 3.15. This means that traditional banks, being typically blessed with broader networks and diversified services, are a challenging task for the development of Islamic banks. This is in line with literature whereby various authors emphasize that Islamic banks ought to distinguish themselves from religious conformity by improving the quality of service, technology innovation, and customer relationship (Kassim & Majid, 2010).

In product competitiveness, too, the average rating of 2.92 indicates that the respondents, for the most part, were neutral, or held a mixed opinion regarding whether or not Islamic banking products are competitively priced and marketed. This type of neutrality indicates a potential gap in product development and positioning which can prevent Hijera Bank from appealing to a wider customer base. In addition, the same level of neutrality was realized in terms of whether or not the distinctive value proposition of Islamic banking is communicated to the broad general public at large, on a mean average of 2.92. This is indicative of the presence of a communication gap, in that the majority of Ethiopians could still not appreciate or comprehend the ethical, risk-sharing, and Shariah-compliant characteristics that distinguish Islamic banking from the

conventional forms. Viable Islamic banks have been found to spend heavily on public awareness and customer education to gain a good reputation in the market (Dusuki & Abdullah, 2007).

Finally, competition from the conventional banks is also observed to limit Islamic bank market share growth with the comparatively high mean score of 3.07. This implies that, without planned action, Islamic banks like Hijera could continue to be susceptible to market penetration issues. Therefore, Hijera Bank must not only design the pricing and product form of its Islamic banking services but also induce customer awareness by proper marketing and stakeholder communication. The final conclusion is that to become a market leader in the Ethiopian banking industry, Hijera Bank must design its competitive edge through marketing its differentiation, increasing financial literacy, and improving services delivery.

This observation underlines that market competition and limited differentiation remain key obstacles to the growth of interest-free banking services in Ethiopia, necessitating strategic marketing, product development, and customer awareness campaigns.

Table 4.9: Descriptive statistics of Competition and Market Dynamics

Question	Strongly Disagree (%)	Disagree (%)	Neutral (%)	Agree (%)	Strongly Agree (%)	Mean	Std. Dev.
Islamic banks in Ethiopia face strong competition from conventional banks.	18.0	16.7	20.1	23.4	21.9	3.15	1.41
Islamic banking products are competitive in terms of pricing and features.	23.4	16.9	21.4	20.3	18.0	2.92	1.42
The unique value proposition of Islamic banking is well communicated to the public.	20.8	20.6	22.1	18.5	18.0	2.92	1.39
Competition from conventional banks limits the market share growth of Islamic banks.	21.1	16.7	18.2	22.7	21.4	3.07	1.45
Aggregate mean and Std. Dev						3.01	1.42

Source: Own Survey Compiled Using SPSS, 2025

4.12. Interview Result Analysis

The qualitative data gathered through interviews provided rich context to support and enrich the quantitative survey results. When asked about the operational challenges facing Islamic banking in Ethiopia, the respondent's majority identified limited public awareness and exposure to Shariah-compliant financial products. They emphasized that as demand rises, interest-free banking misconception continues to influence the populace in general. One of the Shariah compliance officers clarified that the majority of potential customers mistakenly believe Islamic banking is designed for Muslims alone or that it depends solely on donations, and therefore cannot penetrate the mainstream market. In addition, interviewees cited the lack of well-educated human capital as a key hindrance. Despite Hijra Bank having made some progress in training employees, there remain few professionals with deep knowledge of modern finance and Islamic law. This corroborates the findings of the survey, whereby interviewees also made mention of capacity-building needs and scarcity of Shariah professionals.

The second question aimed at the regulatory environment and the manner in which it impacts Islamic banking operations. All the informants indicated that the current legal and regulatory environment within Ethiopia is not yet sufficiently tailored to suit the unique nature of Islamic banking. They emphasized the absence of specific Islamic financial products like Sukuk and the inadequate comprehensive guidelines on profit-sharing arrangements like Mudarabah and Musharakah. Regulatory uncertainty in some cases causes delay in operation and hinders innovation, particularly in product origination and structuring of investments, a branch manager said. Despite the general support of interest-free banking by the National Bank of Ethiopia, the respondents requested more precise policy changes and capacity-building support to regulators to enhance regulation and facilitate sector growth.

Finally, in terms of the potential for financial inclusion growth, all six of the interviewees agreed that Islamic banking has a great level of potential in helping the financial inclusion vision of Ethiopia. They referenced its appeal among religiously conservative customers who remain unbanked due to ethical opposition to interest-yielding financial instruments. In addition, some of the informants mentioned that Islamic banking can attract micro and small enterprises, especially in rural and semi-urban areas, if products are suitably designed and distributed at affordable methods like mobile banking and partnerships with microfinance institutions. One of

the senior workers highlighted grassroot-level education campaigns on finances, and more crucially, those involving religious leaders as a way of promoting public trust and awareness. In general, the interviews confirmed that while Islamic banking poses serious structural and awareness-based issues, its future prospects in Ethiopia are bright—especially if institutional support and regulatory changes are pursued vigorously.

4.13. Secondary Data Analysis Hijra Bank Banking Development and Performance

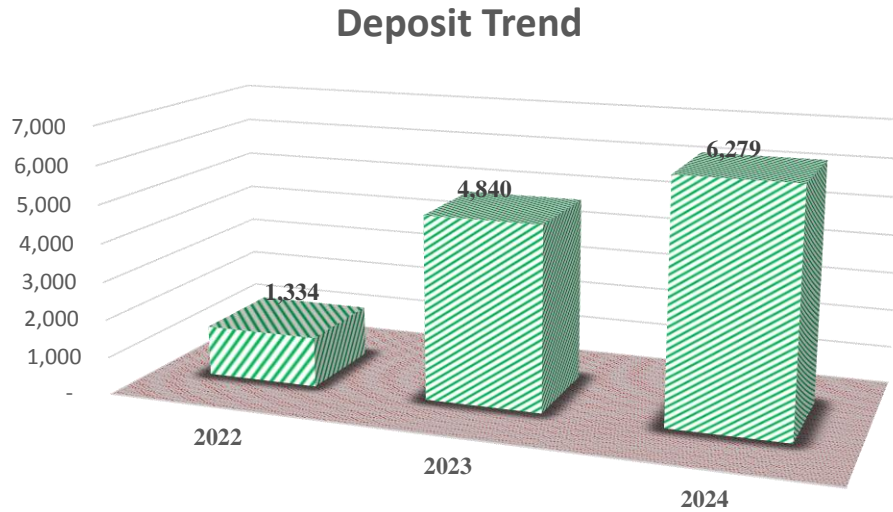
To provide color to the data received from the primary data, secondary data were gathered and analyzed from institutional sources such as Hijra Bank annual reports, performance reports, and strategy papers, and relevant directives published by the National Bank of Ethiopia. The analysis is targeting the growth and performance of the bank over the three-year span between 2022 and 2024, and in particular the growth and sustainability of interest-free banking products in the Ethiopian environment.

4.13.1. The performance of the IFB in Hijra Bank

4.13.1.1. Interest-Free Deposit Trends and by product

Throughout 2022-2024, Hijra Bank had a phenomenal upward trend in interest-free deposit mobilization, which reflects the growing popularity and trust in Shariah-compliant banking in Ethiopia. In 2022, the Bank utilized deposits of 1.334 billion birr, which significantly grew to 4.840 billion birr in 2023 and increased to 6.279 billion birr in 2024. The growth by over four times in two years bears witness not only to greater public confidence in interest-free financial products but also to the success of Hijra Bank's customer acquisition efforts, service delivery improvement, and publicity campaigns. The uptrend in deposits also reflects expanding demand for Shariah-compliant and ethical financial products, supported by expanding customer bases. Yet, the trend to sustain this growth is fraught with various key challenges like sustained innovation in product development, enhancement of digital banking infrastructure, and value outreach to financially excluded and rural communities to enhance market inclusion.

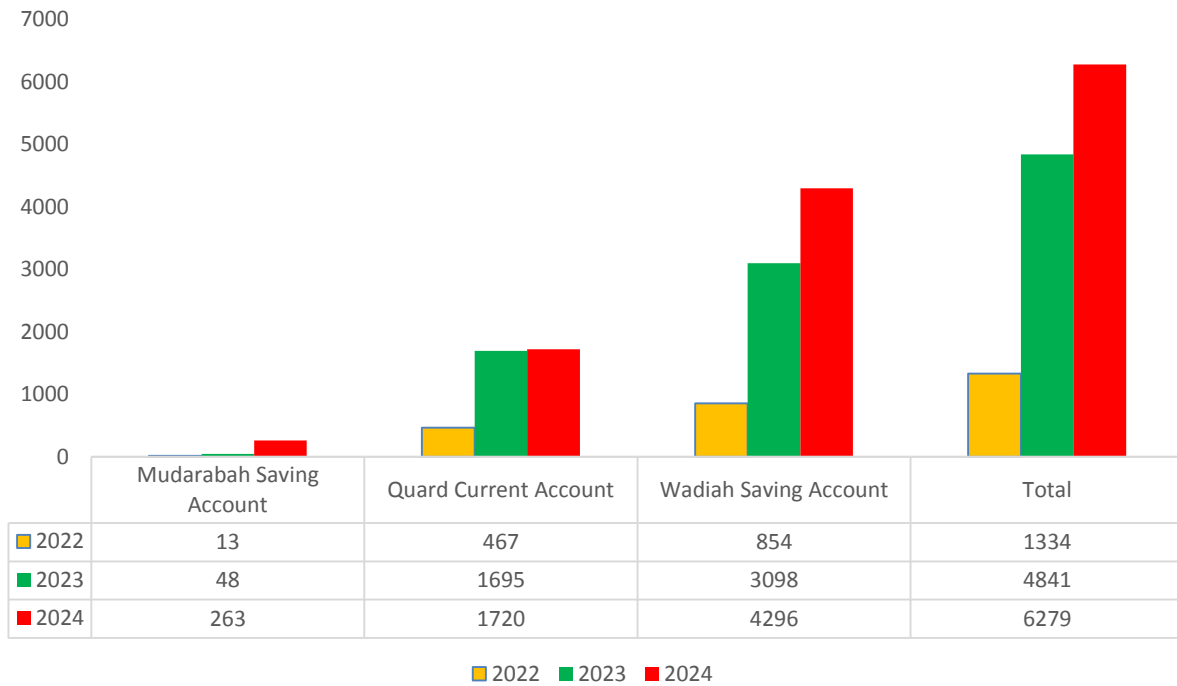
Figure 4.1: Deposit Performance trend of Hijra Bank



Source: National Bank of Ethiopia, 2024, Own compiled

The deposit mobilization trend by product type of Hijra Bank between 2022 and 2024 reveals some useful insights regarding customers' affinity and the contribution of products. The Wadiah Saving Account always attracted the highest deposits, with its figure increasing from 854 million birr in 2022 to 4.296 billion birr in 2024, indicating customers' affection for risk-free, non-profit-yielding savings products. Similarly, the Quard Current Account registered steady growth from 467 million birr in 2022 to 1.720 billion birr in 2024 as it appeals to customers and businesses that require liquidity as well as flexibility in transactions. Of specific interest is the Mudarabah Saving Account that started with a low level of 13 million birr in 2022 but shot up quickly to 263 million birr in 2024, suggesting improving awareness and rising interests in profit-sharing saving schemes. Collectively, the deposits grew from 1.334 billion birr in 2022 to 6.279 billion birr in 2024, which reflects Hijra Bank's enhanced market penetration and strengthening demand for Islamic banking products in Ethiopia. Despite these positive trends, the bank faces difficulties diversifying its products and has yet to educate the market to deepen and retain customer relationships with its Shariah-compliant products.

Figure 4.2: Deposit mobilization based on product type (in millions)

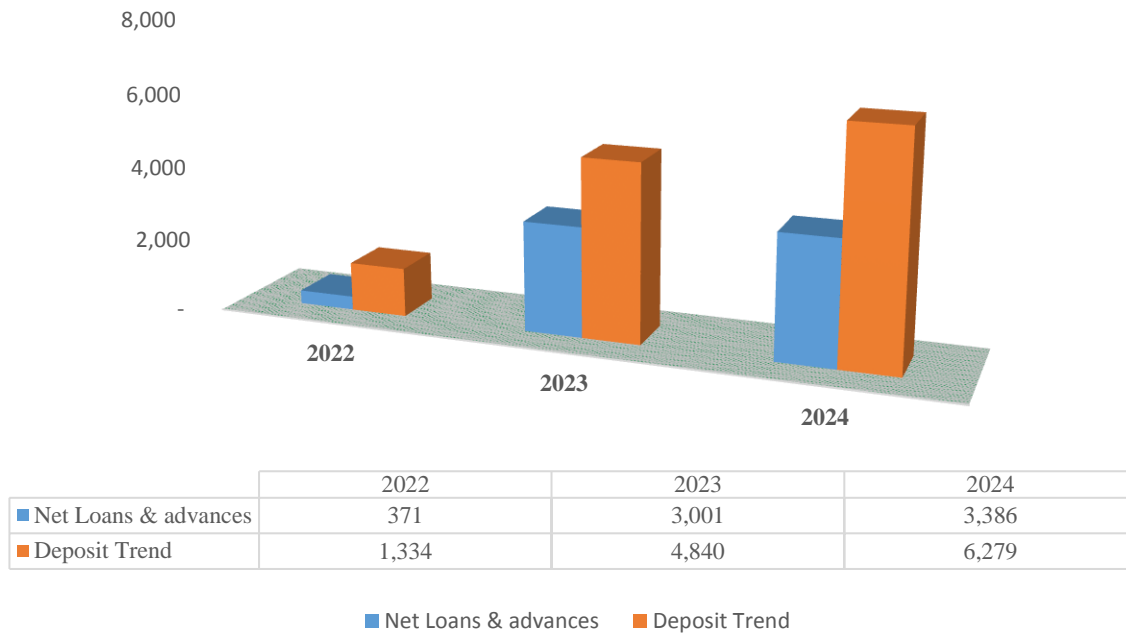


Source: National Bank of Ethiopia, 2024, Own compiled

4.13.1.2. Interest-free financing by Hijra Bank

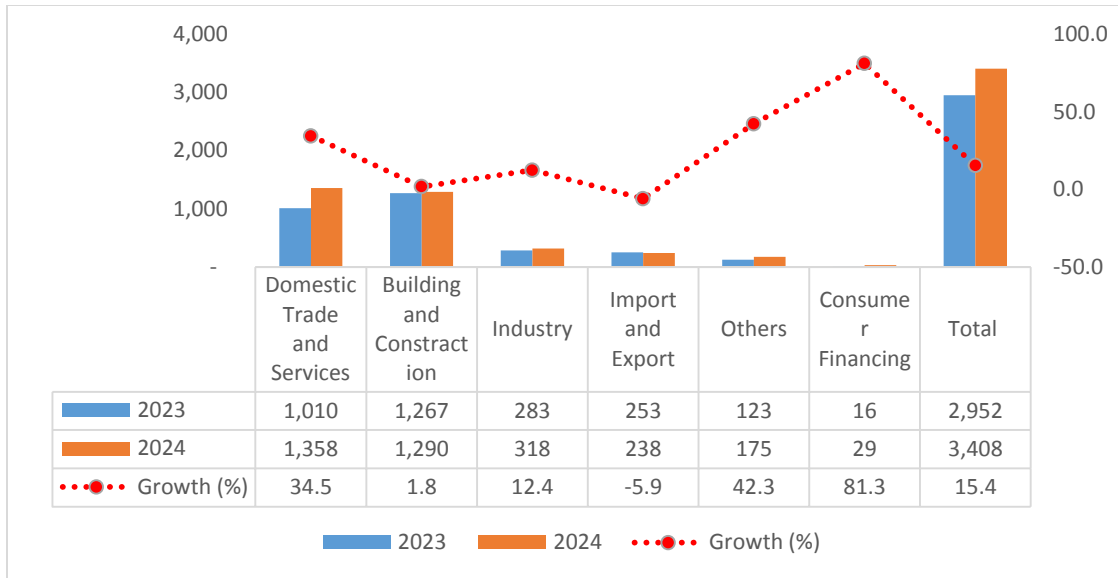
The operational performance of Hijra Bank's interest-free deposits against its Murabaha financing during the period of 2022 to 2024 shows a consistent increase in both fund mobilization and assets deployment. Interest-free deposits increased more than fourfold, from 1.334 billion birr in 2022 to 6.279 billion birr in 2024, reflecting greater public confidence in Shariah-compliant banking products. At the same time, the net advances and Murabaha financing loans of the bank increased drastically from 371 million birr in 2022 to 3.386 billion birr in 2024. Although the growth rate for deposits was greater than for the financing portfolio, the positive correlation between the two indicates increasing capability on the part of the bank to successfully channel deposits into Shariah-compliant financing. This mirrors Hijra Bank's good sectoral liquidity management and enhanced demand for Islamic finance products. Yet, the gap between growth in deposits and growth in financing signifies underlying potential for sectorial optimization of the investment of mobilized funds in productive Shariah-compliant assets to enhance operating efficiency as well as financial inclusion.

Figure 4.2: Interest-free deposits vs. Murabaha financing (in millions)



Source: National Bank of Ethiopia, 2024, Own compiled

Besides, Sectoral disbursement of interest-free funding by Hijra Bank in 2023 and 2024 reflects the bank's conscious effort of distributing funding in a wide variety of key sectors of the economy while remaining steadfast with its Shariah principles. The bank's overall financing portfolio grew consistently by 15.4%, from 2.95 billion birr in 2023 to 3.41 billion birr in 2024. Domestic Trade and Services contributed the highest percentage, and they grew considerably by 34.5% to 1.36 billion birr, reflecting strong demand and active circulation of liquidity in these segments. Although Building and Construction had the highest amount of financing, the fact that its marginal growth was 1.8% shows potential market saturation or risk-averse policy on investment. Financing by the industries increased by 12.4%, which reflects the bank's unabated support for productive economic activities. Import and Export financing decreased by 5.9%, perhaps owing to foreign currency shortages and regulatory pressures on cross-border transactions. Consumer Financing recorded 81.3% growth, albeit from a low base, indicative of consumers' increasing confidence and buying power. In addition, the "Others" category increased by 42.3%, an indicator of expanding base for financing. Overall, these trends indicate Hijra Bank's effort to balance risk and opportunity in various sectors towards inclusive economic growth while overcoming the handicaps unique to interest-free banking in Ethiopia.

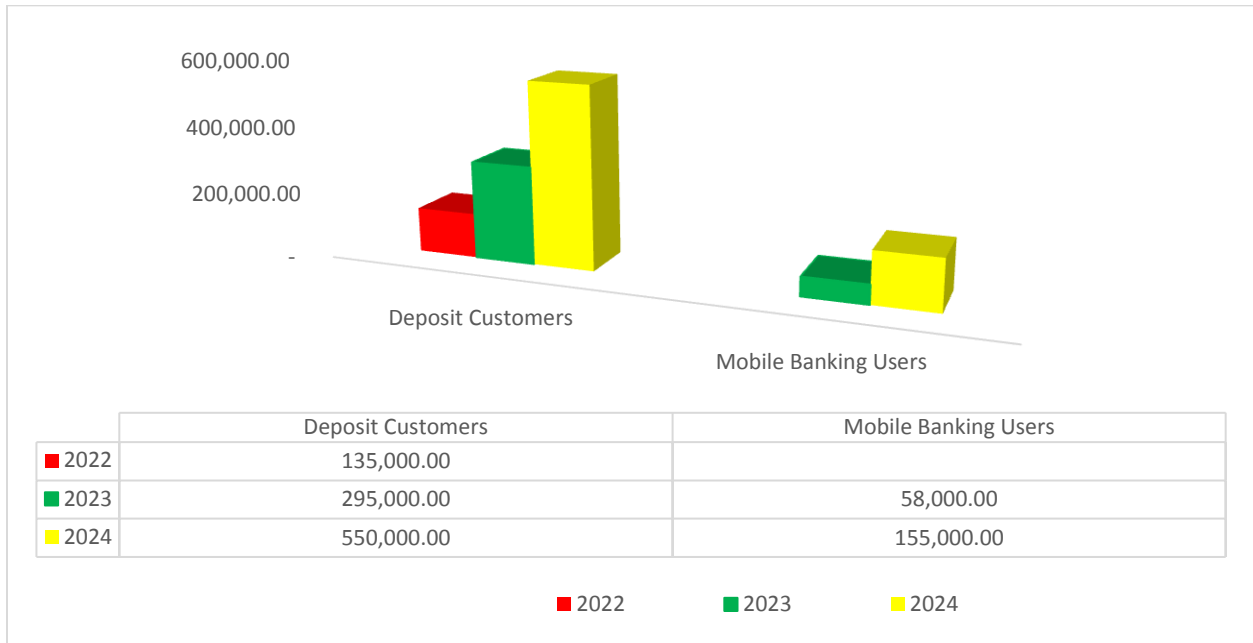


Source: National Bank of Ethiopia, 2024, Own compiled

4.13.1.3. Interest-Free Accounts Size and Mobile Banking Users

Hijra Bank's success in outreach and growing acceptability for Shariah-based financial products is well-demonstrated by the three-year high growth rate in mobile banking customers and interest-free deposit account holders. The interest-free deposit customers rose from 135,000 in 2022 to 295,000 in 2023 and up to 550,000 as of 2024, demonstrating an impressive 307% increase during the period. This rapid expansion reflects enhanced trust in Islamic banking principles and Hijra Bank's appeal with new recruits. Concurrently, mobile banking customers increased from 58,000 in 2023 to 155,000 in 2024, a whopping 167% year-over-year increase, substantiating high digital adoption. This is a reflection of the bank's digital infrastructure and financial inclusion investments, making Shariah-compliant banking accessible, especially to young, technology-savvy populations. With growing ownership of accounts and increased usage of electronic banking, this is a paradigm shift in customer behavior toward more technology-based and adaptive Islamic financial services, with both challenge and opportunity ahead for future growth for the bank.

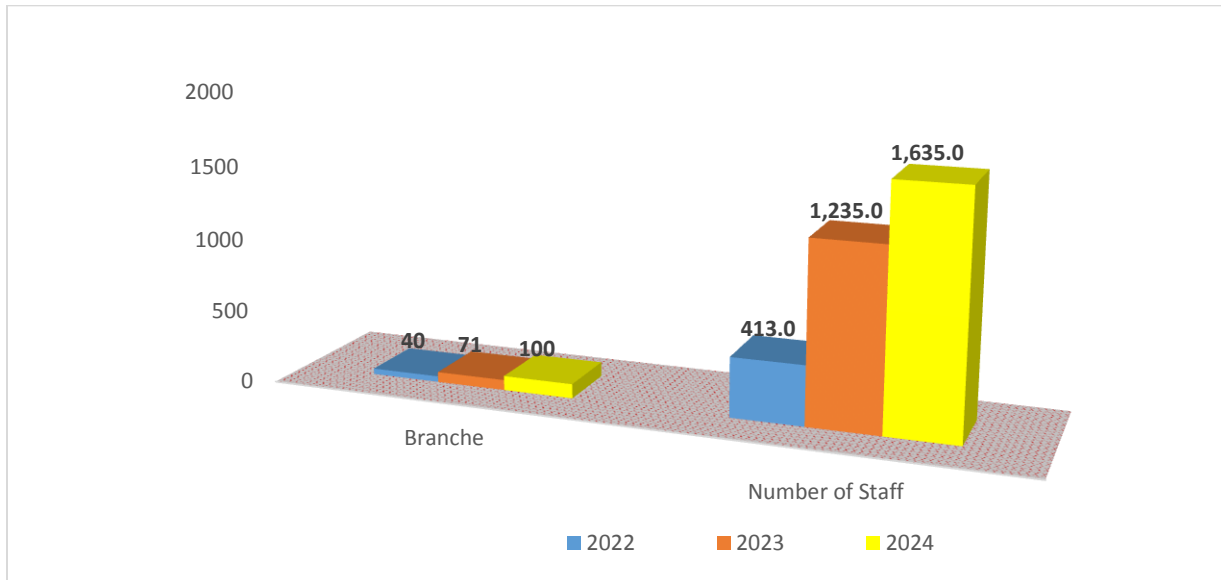
Figure 4.3: Interest-Free Accounts Size and Mobile Banking Users ((In Thousands))



Source: National Bank of Ethiopia, 2024, Own compiled

Hijra Bank recorded remarkable organizational growth in its physical presence and human resource capacity over the past three years. The bank grew its branch network from 40 branches in 2022 to 71 in 2023 and 100 branches in 2024 a 150% growth in this period. The growth is an expression of the strategic resolve of the bank to become more accessible and promote increased financial inclusion, particularly in underserved parts of Ethiopia. Simultaneously, the bank's human resources grew exponentially, with the number of staff growing from 413 in 2022 to 1,235 in 2023, and once more to 1,635 in 2024, an almost 296% expansion. This rapid manpower expansion is proportionate to the expanding universe of operations and burgeoning customer base fueled by robust demand for Islamic banking products. The human resource growth mirrors the higher institutional capacity to deliver an extended portfolio of diversified, efficient, and Shariah-compliant interest-free financial products and services and to improved customer interaction and operational effectiveness through an extended network of strong branches.

Figure 4.4: Number of branches and staff

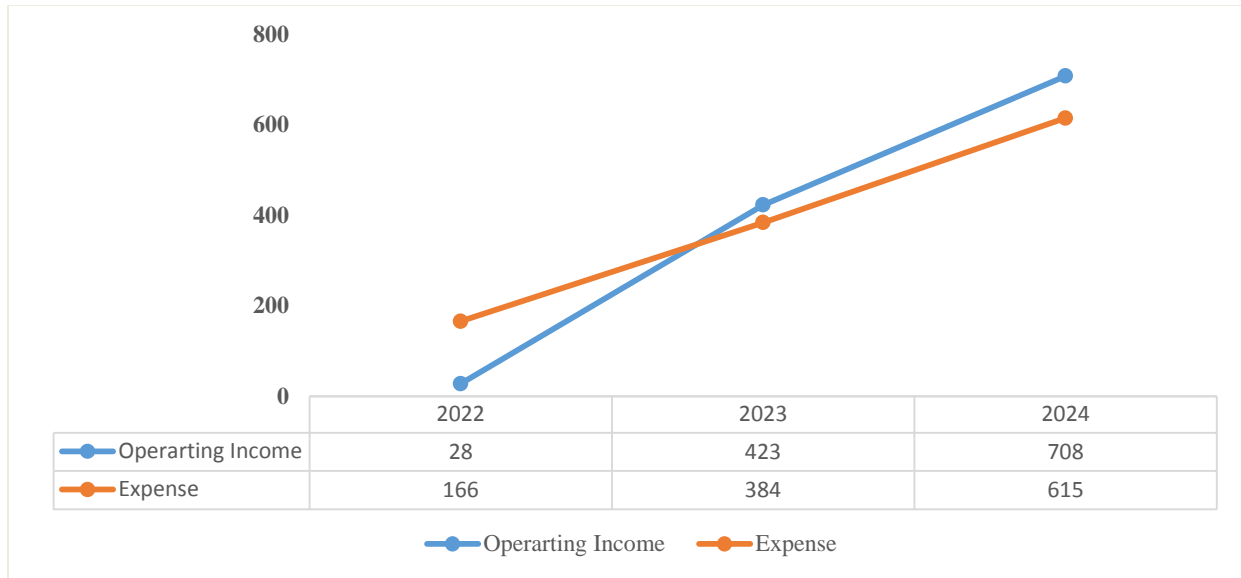


Source: National Bank of Ethiopia, 2024, Own compiled

4.13.1.4. *Income from interest-free financing and associated expenses*

Operating performance of Hijra Bank in the revenue of interest-free financing was impressive for the three-year time frame from 2022 to 2024. The bank's operating profit rose impressively from a modest amount of 28 million birr in 2022 to 423 million birr in 2023 and then to 708 million birr in 2024. This upward trend reflects the increasing demand and profitability of Shariah-compliant financial products such as Murabaha, Ijara, and Mudarabah. This was accompanied by a rise in the bank's operating expenses too from 166 million birr in 2022 to 384 million birr in 2023, and up to 615 million birr in 2024 highlighting expense-led growth through rapid expansion and scaling of business. Despite rising expenses, net operating margin rose consistently, which reflected enhanced financial sustainability. The narrowing gap at the end of the period between revenues and costs indicates the bank's path towards the more cost-effective operations, greater institutional maturity, and more solid profit base in Ethiopia's competitive Islamic banking market.

Figure 4.5: Income from interest-free financing and associated expenses

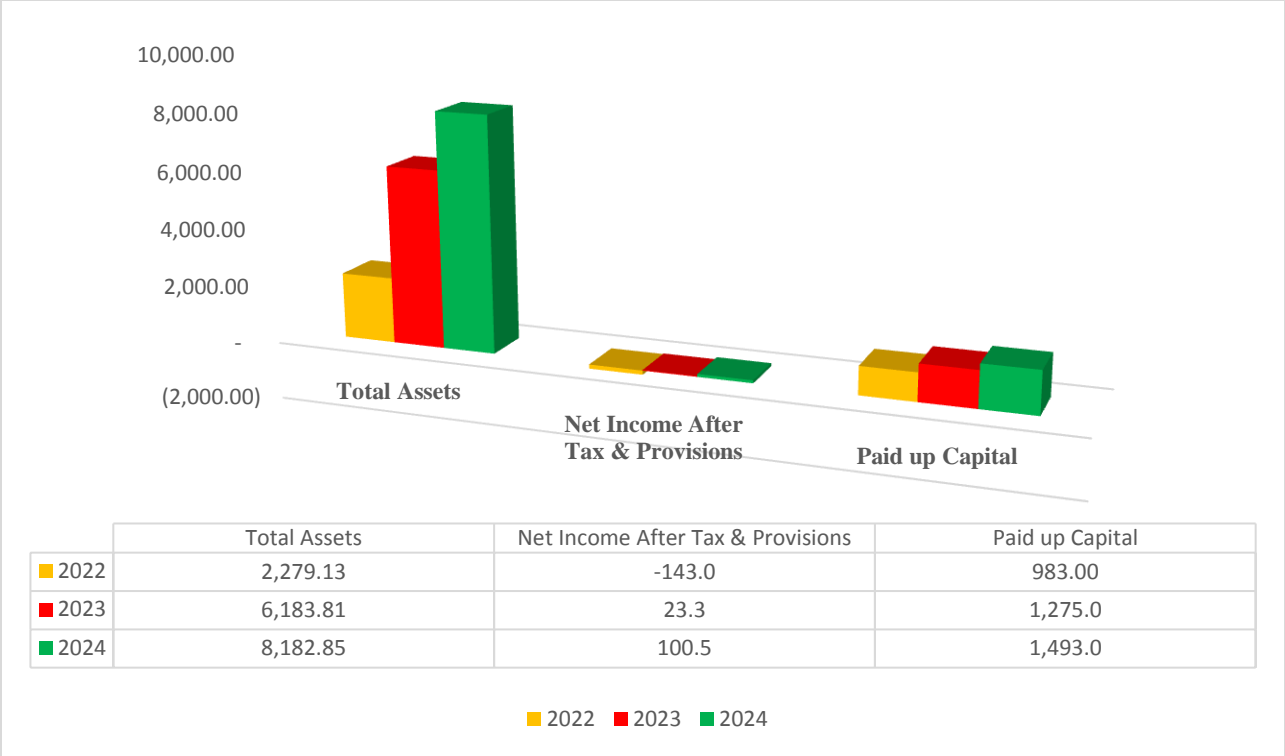


Source: National Bank of Ethiopia, 2024, Own compiled

4.13.1.5. Total Assets, Net Income After Tax & Provisions, and Paid-Up Capital of Hijra Bank

Between 2022 and 2024, Hijra Bank witnessed remarkable financial increase and capital accumulation, reflecting its evolving position in Ethiopia's interest-free banking sector. The bank's total assets grew significantly over three times, from 2.28 billion birr in 2022 to 6.18 billion birr in 2023, and further to 8.18 billion birr in 2024. Such consistent asset growth reflects the bank's higher ability for deposit mobilization as well as the expanding coverage of its financing operations. Net profit after taxation and provisions also improved, from a loss of 143 million birr during 2022 to a marginally positive profit of 23.3 million birr during 2023, before rising substantially to 100.5 million birr in 2024. This improvement is a good sign of better operational efficiency, better cost control, and effective recovery path. In addition, paid-up capital improved steadily from 983 million birr in 2022 to 1.27 billion birr in 2023 and to 1.49 billion birr by 2024, demonstrating steady shareholder confidence and efforts at achieving capital adequacy. Cumulatively, these financial indicators demonstrate that Hijra Bank has overcome its initial teething challenges, consolidated its finance pillar, and is now a mature, stable, and promising entity in Shariah-compliant banking in Ethiopia.

Figure 4.6: Total Assets, Net Income After Tax & Provisions, and Paid-Up Capital



Source: National Bank of Ethiopia, 2024, Own compiled

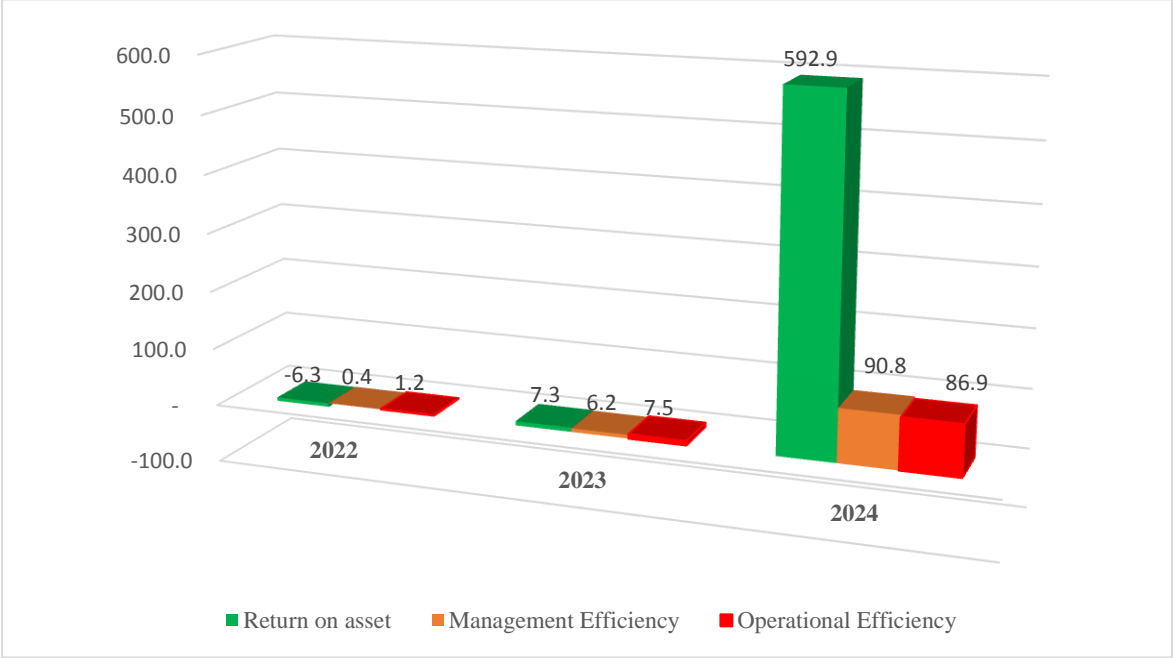
The bottom line of Hijra Bank between 2022 and 2024 indicates marked growth in key indicators. In 2022, the bank had a return on asset of -6.3 percent, calculated by dividing a net loss of 143 million birr into a total asset value of 2,279.13 million birr and then multiplying by 100. In 2023, the return on asset was up to 0.4 percent, calculated from a net income of 23.3 million birr against 6,183.81 million birr in total assets. In 2024, the ratio further rose to 1.2 percent, with the net income of the bank rising to 100.5 million birr and total assets reaching 8,182.85 million birr.

When looking at management efficiency, the ratio was 7.3 percent in 2022, which was calculated by dividing operating expenses of 166 million birr by total assets of 2,279.13 million birr and then as a percentage. In 2023, the effectiveness of management also rose by a small margin to 6.2 percent based on total expenses of 384 million birr and assets of 6,183.81 million birr. However, in 2024, the ratio escalated to 7.5 percent due to higher operating expenses of 615 million birr against assets of 8,182.85 million birr.

Operational efficiency likewise drastically improved. It was exceptionally high in 2022 at 592.9 percent, which was the result of operating expenditures totaling 166 million birr divided by 28

million birr in revenues. This measure decreased significantly to 90.8 percent in 2023 because the bank had 384 million birr in expenditures and 423 million birr in revenues. It went down further to 86.9 percent in 2024, backed by 615 million birr in costs and 708 million birr in operating profit. These events reflect the fact that Hijra Bank has been succeeding in managing cost pressure and improving income generation gradually.

Figure 4.7: ROA, Operational efficiency and management efficiency



Source: National Bank of Ethiopia, 2024, Own compiled

In summary, the Hijra Bank's financial performance report between 2022 and 2024 gives insightful information regarding the challenges as well as prospects of interest-free banking operations in Ethiopia. Throughout these three years, the bank reflected significant improvements in all the core areas of finance, reflecting growing public acceptance and institutionalization of Islamic banking. Assets increased from 2.28 billion birr in 2022 to 8.18 billion birr in 2024, along with an equivalent rise in interest-free deposits from 1.33 billion birr to 6.28 billion birr. Such runaway growth in deposits is a reflection of growing public confidence and active engagement in Shariah-compliant financial instruments. Moreover, the customer base increased significantly as deposit account holders increased from 135,000 in 2022 to 550,000 in 2024, while mobile banking clients increased to 155,000 by 2024. Such embracement of

technology points towards promising avenues of offering financial inclusion based on technological incorporation in Ethiopia's Islamic banking industry.

On a financing basis, the bank's interest-free loan portfolio, dominated by Murabaha financing, increased from 371 million birr in 2022 to 3.39 billion birr in 2024. Sectoral analysis illustrated robust participation in domestic trade and service, construction, and industry, whereas consumer lending experienced a remarkable growth rate of over 81% within a single year. Such trends indicate that Hijra Bank is capable of diversifying its financial intermediation and extending its market coverage deeper. There was a major drop in financing for import-export trade, likely a sign of wider macroeconomic strain and regulatory problems with international trade.

In financial performance terms, Hijra Bank transitioned from a net loss of 143 million birr in 2022 to a net profit of 100.5 million birr in 2024, indicating improved revenue generation and prudent cost management. Paid-up capital also increased to 1.49 billion birr, furnishing a firmer foundation for sustainable growth as well as enhanced financial resilience. Efficiency ratios also corroborate this promising trend; Return on Assets (ROA) increased from -6.3% in 2022 to 1.2% in 2024, reflecting better asset utilization, while operating efficiency showed substantial improvement as the operating expense ratio to income fell from 592.9% to 86.9%. Effectiveness in management was consistent, reflecting quality cost containment as a function of the bank's asset size.

Despite these findings, experience with interest-free banking in Ethiopia, as reflected in the case of Hijra Bank, continues to be plagued by such issues as high operating costs, low profitability in the initial years, and external factors like regulatory challenges and macroeconomic volatility. Even so, prospects look bright, fueled by growing customer adoption, enhancing profitability, and operational improvements. These challenges can be addressed only by consistent capacity building, technological advancement, and enabling policy regimes. In general, Hijra Bank's performance is evidence that with strategic intention and continuous innovation, interest-free banking can be a sustainable, viable pillar of the financial structure in Ethiopia.

CHAPTER FIVE

5. SUMMARY, CONCLUSION, AND RECOMMENDATIONS

5.1. Summary of the Study

This study investigated the challenges and prospects of interest-free banking services in Ethiopia with focus on Hijra Bank. A descriptive research design and mixed research approach were employed, targeting a total sample size of 384 respondents from Hijra Bank employees and customers. Primary and secondary data sources were utilized in this study for purposeful analysis.

The results of the primary data show a largely positive perception of the growth and embrace of Islamic banking products and services in Ethiopia. The respondents recognized the increased public need for Shariah-compatible financial products and services and saw the potential for the sector to bring in unbanked segments of society, consequently promoting financial inclusion based on risk- and profit-sharing concepts.

However, the study also identified several core problems. There is no established regulatory mechanism for Islamic banking in Ethiopia, which lacks consistency and introduces uncertainty and limits growth within the sector. In addition, there is inadequate qualified expertise with knowledge of the concepts of Islamic finance that has hindered operational effectiveness and innovation. Respondents additionally indicated that digital banking infrastructure does not suitably develop to be Shariah-compliant, thus limiting greater access and technology integration.

The study concentrated on Islamic and conventional banks' cooperation necessity as a strategic means towards product innovation that can address Ethiopia's diverse financial requirements. In addition, the research suggests there exists an enormous knowledge gap between the public's

exposure to Islamic banking, further necessitating public sensitization campaigns and financial education programs.

In summary, the study identified Islamic banking to have a great potential for the financial sector in Ethiopia, with possibilities of ethical finance, diversification of investments, and economic inclusion. But the potential needs to be realized by surmounting present challenges—above all, regulation, human resource building, and technologizing alignment—through policy and institutional collective action.

The study also identified that modest product differentiation and competition in the market remain huge challenges. To overcome them, Islamic banks are required to conduct strategic marketing, product development, and customer education that are responsive to the unique needs of the Ethiopian masses.

On the human capital aspect, the establishment and sustainability of interest-free banking in Ethiopia were mainly dependent on efforts to respond to the lack of experienced practitioners and improve the institutional capacity for training within the sector.

Secondary data analysis further illuminated Hijra Bank's financial performance from 2022 to 2024, which provided empirical evidence of the operational growth and developing trends in Islamic bank service provision.

- ❖ Total assets grew dramatically from ETB 2.28 billion in 2022 to ETB 8.18 billion in 2024 following corresponding increases in interest-free deposits from ETB 1.33 billion to ETB 6.28 billion, reflecting growing public trust and demand for Shariah-compliant products.
- ❖ The number of deposit customers rose from 135,000 in 2022 to 550,000 in 2024, the mobile banking users numbered 155,000 by 2024, and this holds a high prospect for technology adoption and digital inclusion in the Islamic banking system.
- ❖ The bank's interest-free lending, in the form of Murabaha, increased from ETB 371 million in 2022 to ETB 3.39 billion in 2024. Sectoral absorption was significant in domestic trade, services, construction, and industry, while consumer lending increased by over 81% in one year. Finance for the import-export sector decreased, maybe due to macroeconomic or regulatory issues.

- ❖ From the profitability perspective, the bank reversed its financial position, from a net loss of ETB 143 million in 2022 to a net profit of ETB 100.5 million in 2024, reflecting improved revenue generation and effective cost control.
- ❖ The paid-up capital increased to ETB 1.49 billion, which improved the financial base and viability of the bank.
- ❖ Efficiency actions posted notable improvement: Return on Assets (ROA) altered from -6.3% to 1.2%, while operating expense ratio declined noticeably from 592.9% to 86.9%, indicating significant operational efficiency enhancement. Management efficiency remained unchanged, yet had consistent cost controlling habits.

The outcomes this study show that despite the startup costs and profitability problems at the beginning, the bank has achieved remarkable performance. The future for interest-free banking in Ethiopia seems rosy in terms of customer take-up, enhanced efficiency, and institutional strengthening. But long-term growth was involving continued investments in human capacity building, technology upgradation, and regulatory alignment. These efforts are necessary to make Islamic financial institutions like Hijra Bank viable and competitive players in the Ethiopian financial system.

5.2. Conclusion

This study finds conclusively that interest-free banking in Ethiopia, and in this instance through the experience of Hijra Bank, has immense potential to assist in the development of the country's financial sector. The growing popular demand for Shariah-compliant financial instruments, as evidenced by the rapid growth in customer base, deposits, and online reach, is a reflection of higher acceptability and confidence being generated in Islamic banking principles. This highlights the capacity of interest-free banking to promote financial inclusion, especially for the unbanked and underserved sectors.

However, the study also discovered critical challenges that still hinder the full development of the industry. Foremost among these are the poor and non-standardized regulatory frameworks, deficiencies of skilled human capital in Islamic finance, and below-par technological infrastructure compliant with Shariah requirements. All these institutional and operational gaps seriously challenge the growth, competitiveness, and sustainability of Islamic banking in Ethiopia.

Except for these teething issues, Hijra Bank's business between 2022 and 2024 illustrates the viability and resilience of interest-free banking offered with effective management, innovative products, and customer-centric delivery of services. Its change from net loss to profitability, addition in capital and asset, and improved efficiency ratios all reveal the institution's improved operational competence and positioning in the market.

Therefore, it can be argued that interest-free banking operations, if marketed with robust regulatory mechanisms, directed human capital intervention, and enhanced technological incorporation, can assume the role of an evolutionary force for Ethiopia's financial industry. Strategic alliances, education of the masses, and additional institutional empowerment was essential to guarantee Islamic banking becomes an evolutionary product from a niche market towards a mainstream financial instrument for inclusive and moral economic development.

5.3. Recommendations

Based on the findings and conclusions of the present study, the following recommendations are made to support interest-free banking activities in Ethiopia:

- ❖ **Strengthen Regulatory Framework:** The National Bank of Ethiopia and government policymakers need to enact clear, regular regulations for Islamic banking, e.g., Shariah governance and conflict resolution, in order to reduce legal uncertainties and promote growth.
- ❖ **Build Human Capital:** Interest-free banks like Hijra Bank should invest in the recruitment and training of professionals with knowledge of Islamic finance, collaborating with universities and overseas institutes to build certification and career programs.
- ❖ **Boost Technology Integration:** Banks should give top priority to Shariah-compliant online platforms and mobile banking to increase efficiency and reach more customers, especially in remote markets.
- ❖ **Raise Public Awareness:** The public awareness of Islamic banking concepts, products, and benefits must be increased through special campaigns and financial literacy to overcome knowledge gaps and increase acceptance.

- ❖ **Foster Product Innovation:** Islamic banks must diversify products from Murabaha to Ijara, Musharakah, Mudarabah, and Sukuk in order to meet varied customer needs and boost competitiveness.
- ❖ **Foster Strategic Partnerships:** Strategic partnerships between Islamic banks, conventional banks, and microfinance institutions are able to marshal resources and improve access to interest-free financial products.
- ❖ **Monitor Institutional Performance:** Regular inspections of financial health, customer satisfaction, and Shariah compliance need to be done to promote transparency and continuous development.

5.4. Suggestions for Future Study

This study focused on the challenges and prospects of interest-free banking in Ethiopia using Hijra Bank as a case study. While descriptive and mixed methods were predominantly employed in this research, future research can employ regression analysis to examine quantitatively the key determinants of the adoption and performance of interest-free bank services in Ethiopia. For example, logistic or multiple regression models can be used to explore the influence of public awareness, technological accessibility, regulatory clarity, and employee knowledge on customer satisfaction and use of Islamic bank services. In addition, time-series regression can be applied to examine how financial performance metrics (return on assets, growth in profit) are associated with internal/external determinants over time. Such empirical approaches would provide more comprehensive, evidence-based data for academic as well as policy-level decision-making.

References

- Abate, A. (2016). The Regulation and Supervision of Interest-Free Banking in Ethiopia (Unpublished Master's thesis, Addis Ababa University)
- Abdul Rahim, A., (2007), 'Islamic Micro finance: A Missing Component in Islamic Banking', Kyoto Bulletin of Islamic Area Studies, Vol. 1(2) pp. 38-53.
- Abdulkadir Wahab Aman, Abdu Seid Ali, and Abdurahman Jemal Yesuf (2020) "The potential critical success factors of full-fledged interest-free banks in Ethiopia" Journal of Economics Bibliography 7(4), p.211-230
- Abubakar, M., & Ibrahim, A. (2021). Human capital challenges in the implementation of Islamic banking in Ethiopia: A case study of interest-free banking windows. *Journal of Islamic Banking and Finance*, 9(2), 45–58. <https://doi.org/10.35609/jibf.2021.9.2>
- Adams,J., Khan, H.T.A Raeside, R.,andwhite,D (2007). Research Methods for Graduate Business and Social students. (1sted.). New Delih: Response books.
- Ahamad Faosiy Ogunbado, Umar Ahmed, and Yusuf Abubakar (2017) "Islamic Banking and Finance in Nigeria: Exploration of its Opportunities and Challenges" Faculty of Islamic Development Mangement, Universiti Islam Sultan Sharif Ali (UNISSA), Burnei, Darssalam ISSN : 2454-2415 Vol. 5
- Ahmad M. Abu-Alkheil (2012) "Ethical Banking and Finance: A Theoretical and Empirical Framework for the Cross-Country and Inter-bank Analysis of Efficiency, Productivity, and Financial Performance" University of Hohenheim.

- Ahmed Alharbi (2015) “Development of the Islamic Banking System” *Journal of Islamic Banking and Finance* June 2015, Vol. 3, No. 1, pp. 12-25
- Ahmed, M. I. (2019). The Progress to Allow Full-Fledged Interest Free Banking Business in Ethiopia. *European Journal of Islamic Finance*, (14).
- Ahmed, S., & Mustafa, M. (2022). Regulatory challenges and prospects of Islamic banking in emerging markets: The case of Ethiopia. *Journal of Islamic Finance Studies*, 7(2), 45–62. <https://doi.org/10.1234/jifs.v7i2.1234>
- Alharbi, A. (2015). Development of the Islamic Banking System. *Journal of Islamic Banking and Finance*, 3(1), 12-25
- Al-Hashimi, M., A., 2012: Ethiopian Muslims and the Ahbash controversy. Retrieved January 12, 2020, from <https://crescent.icit-digital.org/articles/ethiopian-muslims-and-theahbash-controversy>
- Ali, S. and Farrukh, F. (2013), ‘Islamic Banking: Is The Confidence Level of Being An Islamic Banking Employee Better Than Conventional Banking Employee? An Exploratory Study Regarding Islamic Banking’, *Journal of Business Studies Quarterly*, Vol. 4(3) P. 27.
- Aljifri, K. and Khandelwal, S. K. (2013), ‘Financial Contracts In Conventional and Islamic Financial Institutions: An Agency Theory Perspective’, *Review of Business & Finance Studies*, Vol. 4(2), pp. 79-88.
- Al-Swidi, A., Saleh, H., & Husniyah, N. (2022). The impact of awareness on the adoption of Islamic banking products: Evidence from emerging economies. *International Journal of Islamic and Middle Eastern Finance and Management*, 15(1), 34–52. <https://doi.org/10.1108/IMEFM-05-2021-0345>
- Alyu, A. (2016). “The Regulation and Supervision of Interest-Free Banking in Ethiopia”. A Thesis Submitted to Addis Ababa University, College of Law and Governance Studies, School of Law. A.A, Ethiopia.
- Ariff, M. (1988), ‘Islamic Banking’, *Asian- Pacific Economic Literature*, Vol. 2(2), pp. 48-64.

- Audu Bello and Mika'iluAbubakar (2014), Challenges and Solutions to Islamic Banking System in a Pluralistic–Secular Country like Nigeria, *Mediterranean Journal of Social Sciences*, Vol 5 No 6 pp 26-27
- Chachi, A. (2005). Origin and development of commercial and Islamic banking operations. *Islamic Economics*, 18(2)
- Chong, B. S. and Liu, M.H. (2009), 'Islamic Banking: Interest-Free or InterestBased?' *Pacific- Basin Finance*.
- Cihak, M. and Hesse, H. (2008), 'Islamic Banks and Financial Stability: An Empirical Analysis.' *IMF Working Papers*, P.1-29.
- Debebe Alemu (2015). Factors Affecting Customers to Use Interest Free Banking in Ethiopia (unpublished project paper)
- Debebe Alemu Kebede (2021) "Interest Free Banking in Ethiopia: Customer Awareness, Satisfaction and its Role on Economic Development" *International Journal of Islamic Business and Economics (IJIBEC)*, 5(1) June 2021,P 48 – 58
- Derbel, H., T. Bouraoui and Dammak, N. (2011), 'Can Islamic Finance Constitute A Solution To Crisis?' *International Journal of Economics and Finance*, pp. 3(3), P75.
- Dusuki, A. and Abdullah, N., (2007), 'Why Do Malaysian Customers Patronise Islamic Banks?' *International Journal of Bank Marketing*, Vol. 25(3), pp. 142-160.
- Dusuki, A. W. (2007), 'Banking for The Poor: The Role of Islamic Banking In Micro finance Initiatives', *Proceedings of The 2nd Islamic Conference Organized By Faculty of Economics and Muamalat, Islamic Science-University of Malaysia*.
- Ebrahim, M. S and Joo, T.K. (2001), 'Islamic Banking in Brunei Darussalam', *International Journal of Social Economics*, 28 (4), pp. 314-337
- Entissar Mohamed Elgadi (2016) "Assessing the Financial Performance of Islamic Banking: The case of Sudanese banks" A thesis submitted in partial fulfilment of the Requirements of the University of East London for the degree of Doctor of Philosophy.

- Feyissa, D. (2012). The transnational politics of the Ethiopian Muslim diaspora. *Ethnic and Racial Studies*, 35(11), 1893-1913.
- Getachew, B., & Ahmed, S. (2022). Regulatory challenges of Islamic banking in Ethiopia: An institutional perspective. *African Journal of Finance and Economic Policy*, 14(1), 67–85. <https://doi.org/10.4314/ajfep.v14i1.5>
- Hailu, S. M., Kapusuzoglu, A., & Ceylan, N. B. (2019). The Role of Islamic Financial Product Innovation in Reduction of Financial Exclusion in Ethiopia. In *Handbook of Research on Managerial Thinking in Global Business Economics* (pp. 426-446). IGI Global
- Haron, S. (1996), ‘The Effects of Management Policy On The Performance of Islamic Banks’, *Asia Pacific Journal of Management*, Vol. 13(2), pp. 63-76.
- Hussain, M., A. Shahmoradi, and R. Turk. 2015. “Overview of Islamic Finance,”
- Ibrahim, M. F., Eng, O. S. and Parsa, A. (2009), ‘Shariah Property Investment in Asia’, *Journal of Real Estate Literature*. pp. 233-248.
- Iqbal, M. and Molyneux, P. (2005). *Thirty Years of Islamic Banking*. Palgrave Macmillan, New York.
- Jemal, N. (2018). “Practices and Challenges of Interest Free Banking Windows of Commercial Banks in Ethiopia”. An MBA Thesis submitted to Addis Ababa University, Department of Business Administration. A.A, Ethiopia.
- Juma Bananuka, Twaha Kigongo Kaawaase, Musa Kasera, and Irene Nalukenge (2019) “Determinants of the intention to adopt Islamic banking in a non-Islamic developing country The case of Uganda” *ISRA International Journal of Islamic Finance* Vol. 11
- Kerima Ali (2016). *Challenges on Interest Free Banking Services: The Case of Commercial Bank of Ethiopia* (unpublished project paper)
- Khan, T., & Shah, M. (2021). Public awareness and acceptance of Islamic banking in sub-Saharan Africa. *African Journal of Economic and Management Studies*, 12(4), 527–544. <https://doi.org/10.1108/AJEMS-09-2020-0382>
- Kothar, C. (2004). *Research Methodology: Methods and Techniques* (2nded.). New Age

- Malhotra, N. and Peterson M. (2006). *Basic Marketing Research*. Highland Park New-Jersey: prentice-hall
- Mohamad, M. T., Abdullah, M. Y., Mohamad, M. A., & Abidin, U. Z. A. A. Z. (2013). The historical development of modern Islamic banking: A study in South-east Asia countries. *African Journal of Business and Management*.
- Mohamed, A., Yusuf, M., & Abdalla, A. (2023). Market development challenges for Islamic finance in Africa: The role of Sukuk and Takaful. *Journal of African Business*, 24(1), 68–86. <https://doi.org/10.1080/15228916.2022.2135678>
- Mohammed Ibrahim 2019 “The Progress to Allow Full-Fledged Interest Free Banking Business in Ethiopia” *EJIF – European Journal of Islamic Finance*
- Mohammed, M (2012), “Islamic banking: Prospects, opportunities and challenges in Ethiopia”. An MBA Thesis submitted to Addis Ababa University, Department of Accounting and Finance. A.A, Ethiopia.
- Mohammed, R., & Tesfaye, Y. (2023). The role of digital transformation in enhancing Islamic banking service accessibility in Ethiopia. *Ethiopian Journal of Business and Economics*, 13(1), 98–113. <https://doi.org/10.1016/ejbe.2023.13.1.7>
- National bank of Ethiopia (2011) "Directives to Authorize the Business of Interest-free Banking No. SBB/51/2011" by the NBE
- Omar, N., Ismail, A., & Saeed, A. (2021). Human capital constraints in Islamic banking: An empirical analysis. *Journal of Islamic Economics, Banking and Finance*, 17(3), 135–151. <https://doi.org/10.12816/jiebf.v17i3.2021>
- Samad, A. (2004), ‘Performance of Interest-free Islamic banks vis-à-vis Interest-based Conventional Banks of Bahrain’, *International Journal of Economics, Management and Accounting*, Vol. 12(2).
- Sarker, A. (2000), ‘Islamic Banking in Bangladesh: Performance, Problems and Prospects’, *International Journal of Islamic Financial Services*, Vol. 1(3), pp. 1-22.
- Shahinpoor, N. (2009), ‘The Link between Islamic Banking and Micro financing’, *International Journal of Social Economics*, Vol. 36(10), pp. 996-1007.

- Siddiqui, A. (2008), 'Financial Contracts, Risk and Performance of Islamic Banking', *Managerial Finance*, Vol. 34(10), pp. 680-694.
- Suadiq Mehammed Hailu *Ibrahim Busher** (2020) "Interest Free Banking in Ethiopia: Prospects and Challenges" *International Journal of Islamic Economics and Finance Studies*, 2020/2: 119-137
- Suadiq Mehammed Hailu, Ömer Faruk Tekdoğan (2023) "Ensuring The Compliance of Islamic Finance Applications with Shariah Principles in Ethiopia: The Way Forward" *Hitit İlahiyat Dergisi*, P139-168.
- Tabash, M. I. (2017). "Critical challenges affecting Islamic banking growth in India using Analytical Hierarchy Process (AHP)". *Banks and Bank Systems*, 12(3), 27.
- Teferi, M (2015), "Contribution of IFB to economic development and its prospect in Ethiopia". An Executive MBA Thesis submitted to Addis Ababa University, Department of management. A.A, Ethiopia.
- Yimer, S., & Abdulahi, K. (2021). Shariah-compliant banking and financial inclusion in Ethiopia: Opportunities and barriers. *International Journal of Islamic and Middle Eastern Finance and Management*, 14(4), 623–641. <https://doi.org/10.1108/IMEFM-04-2021-0172>
- Zainal, A., & Abdullah, M. (2021). Competitive challenges of Islamic windows within conventional banking: Insights from Southeast Asia. *International Journal of Bank Marketing*, 39(6), 1234–1251. <https://doi.org/10.1108/IJBM-09-2020-0516>
- Zamil, M., & Aiza, N. (2014). "An empirical investigation into the problems and challenges facing Islamic banking in Malaysia" (Doctoral dissertation, Cardiff University).

Questionnaire

Section 1: Demographic Information

1. **Age Group**
Below 18, 18-25, 26-35, 36-45, 46-60, Above 60
2. **Gender**
Male, Female
3. **Educational Level**
No Formal Education, Primary, Secondary, Higher Education, Postgraduate
4. **Occupation**
Student, Employee, Business Owner, Unemployed, Retired
5. How long have you been using Islamic banking services at Hijera Bank?
6. Less than 6 months, 6-12 months, 1-3 years, More than 3 years
7. If your response is Employee **How long have you been working at Hijera Bank?**
Less than 6 months, 6-12 months, 1-3 years, More than 3 years

Indicate your level of agreement to each of the following Likert scale items using: (1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, 5 = Strongly Agree)

Section 2: Prospects of Islamic Banking (IFB) in Ethiopia

1. Do you believe the demand for Sharia-compliant financial products and services is growing in Ethiopia, presenting a significant opportunity for expansion?
2. The existing regulatory frameworks in Ethiopia adequately support the growth and innovation of Islamic banking products.
3. There is a sufficient pool of qualified human resources with expertise in Islamic finance within Ethiopia.
4. Collaboration between existing Islamic banks and traditional banks in Ethiopia can unlock new market opportunities.
5. Technological advancements like mobile banking have the potential to increase access to Islamic banking services in Ethiopia.

Section 3: Impacts of Full-fledged Islamic Banking on the Ethiopian Economy and Financial System

6. The introduction of full-fledged Islamic banking could promote financial inclusion by attracting unbanked Ethiopians seeking Sharia-compliant financial products.
7. Islamic financing principles, emphasizing profit-sharing and risk-sharing, could contribute to a more stable and ethical financial system in Ethiopia.
8. The growth of Islamic banking could potentially unlock new investment opportunities in sectors like infrastructure and agriculture in Ethiopia.
9. Full-fledged Islamic banking might lead to increased competition within the Ethiopian financial sector, potentially benefiting customers through better products and lower fees.
10. The Ethiopian financial system may require significant regulatory adjustments to accommodate the unique aspects of Islamic banking operations.

Section 4: Financial Inclusion and Islamic Banking

11. The emphasis on profit-sharing in Islamic banking could make financial products more accessible for Ethiopians with religious reservations about interest.
12. Islamic banking products designed for banks, like Musharaka, could increase access to financing for small businesses run by Ethiopians.
13. The wider availability of Islamic banking services could potentially encourage a larger portion of the unbanked population in Ethiopia to participate in the formal financial system.
14. Lack of awareness and financial literacy about Islamic banking principles might hinder its effectiveness in promoting financial inclusion in Ethiopia.
15. Collaboration between Islamic banks and existing microfinance institutions could create innovative financial products tailored to the needs of unbanked Ethiopians.

Section 5: Perceptions and Attitudes toward Islamic Banking

16. I believe Islamic banking at Hijera Bank is a trustworthy alternative to conventional banking.
17. I have a positive attitude towards using Islamic banking services at Hijera Bank.
18. Islamic banking products at Hijera Bank meet my financial needs more effectively than conventional banking.
19. I am satisfied with the ethical approach of Islamic banking at Hijera Bank.
20. I would prefer Islamic banking services at Hijera Bank over conventional ones for ethical reasons.

Section 6: Challenges in the Growth of Islamic Banking

21. Limited public awareness and understanding of Islamic banking principles create a barrier for existing Islamic banks in Ethiopia.
22. The lack of a well-developed Islamic financial market (Sukuk, Takaful) hinders the product offerings of existing Islamic banks.
23. Competition from conventional banks offering Islamic windows poses a significant challenge for existing Islamic banks.
24. The current regulatory environment in Ethiopia presents challenges for the smooth operation and innovation of Islamic banking products.
25. Recruiting and retaining qualified Shariah scholars and Islamic finance professionals is a challenge for existing Islamic banks in Ethiopia.

Section 7: Cultural and Regulatory Impact on Islamic Banking

26. Ethiopian cultural values emphasizing ethical financial practices would be receptive to the principles of Islamic banking.
27. The current regulatory framework in Ethiopia adequately addresses the specific needs and operations of Islamic banking institutions.
28. Public education initiatives promoting Islamic banking principles could significantly increase its acceptance among Ethiopians.
29. The involvement of religious leaders in promoting financial literacy and the benefits of Islamic banking could positively impact its prospects.

30. Potential concerns about the compatibility of Islamic banking practices with existing Ethiopian financial regulations create a barrier for its growth.

Section 8: Human Resource Capacity

31. There is a shortage of skilled professionals in Islamic banking in Ethiopia.

32. My institution provides enough capacity-building programs in Islamic finance.

33. Adequate expertise in Shariah compliance is available in our organization.

34. More specialized training is needed to improve staff knowledge in Islamic banking

Section 9: Competition and Market Dynamics

35. Islamic banks in Ethiopia face strong competition from conventional banks.

36. Islamic banking products are competitive in terms of pricing and features.

37. The unique value proposition of Islamic banking is well communicated to the public.

38. Competition from conventional banks limits the market share growth of Islamic banks.

Appendix: Key Informant Interview Questions

- What are the major operational challenges facing Islamic (interest-free) banking in Ethiopia, particularly at Hijra Bank?
- How do you assess the current regulatory and policy environment for supporting the growth and sustainability of Islamic banking in Ethiopia?
- In your view, what opportunities does Islamic banking offer for enhancing financial inclusion in Ethiopia, and what strategies should be adopted to realize this potential?