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**OPERATIONAL CHALLENGES AND OPPORTUNITIES OF INTEREST FREE
BANKING IN ETHIOPIA**

A THESIS SUBMITTED TO

**THE DEPARTMENT OF ACCOUNTING AND FINANCE IN THE PARTIAL
FULFILLMENT OF THE REQUAIRMENT FOR THE DEGREE OF MASTERS OF
SCIENCE IN ACCOUNTING AND FINANCE**

BY:

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ADDIS ABABA, ETHIOPIA

MARCH, 2018

Statement of Declaration

I hereby declare that all information in this document has been obtained and presented in accordance with academic rules and ethical conduct. I also declare that, as required by these rules and conduct, I have fully cited and referenced all material and results that are not original to this work. And this research is my original work and has not been presented for and award of degree in any other University.

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Date

Statement of Certification

This is to certify that Wondwosen Teshome has carried out this research work on the topic entitled “*operational challenges and opportunities of interest free banking in Ethiopia*” under my supervision. This work is original in nature and it is sufficient for submission for the partial fulfillment for the award of MSc. in Accounting and Finance.

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This is to certify that the thesis prepared by Wondwosen Teshome, entitled: “*operational challenges and opportunities of interest free banking in Ethiopia*” and submitted in partial fulfillment of the requirements for the Degree of Masters of Science (Accounting and Finance) complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

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Table of Contents

Acknowledgements.....	v
LIST OF TABLE.....	viii
ACRONYMS AND ABBREVIATIONS.....	ix
Abstract.....	1
CHAPTER ONE.....	2
INTRODUCTION.....	2
1.1 BACKGROUND OF THE STUDY.....	2
1.2 Statement of the problem.....	4
1.3 Research Questions.....	5
1.4 Research Objective.....	5
1.4.1 General objective.....	5
1.4.2 Specific objective.....	5
1.6 Significance of the Study.....	6
1.7 Scope and Limitation of the Study.....	6
1.7.1 Scope of the Study.....	6
1.7.2 Limitations of the Study.....	7
1.8 Organization of the Study.....	7
CHAPTER TWO.....	8
LITERATURE REVIEW.....	8
2.1 INTRODUCTION.....	8
2.2. Theoretical Literature.....	8
2.2.1 Concepts of Interest Free Banking.....	8
2.3 Evolution of Islamic Banking.....	10
2.4 The Principles of Interest free banking.....	10
2.4.1. Interest (riba).....	10
2.4.2. Gharar and Maysir.....	11
2.4.3. Unethical businesses.....	11
2.5 The Fundamental of Interest Free Banking and Finance.....	11
2.6 Shariah Advisory Council/ Consultant.....	13
2.7 The three Legal Maxims of IFB.....	13
2.8 Islamic /IFB Mode of operations.....	14
2.9 Operational Challenges faced by Interest free banking.....	14
2.9.1 Legal and Regulatory Challenges.....	15
2.9.1.1 International Regulating Bodies.....	15
2.9.1.2 International Financial Services Board (IFSB).....	16
2.9.1.3 Accounting and Auditing Organization for Islamic financial institutions (AAOIFI).....	16
2.9.2. Shortage of Sharia'a experts and human capital resources.....	17
2.9.3. Concentrated Banking: Limited Risk Management Functionality.....	18
2.9.4. Cash Requirements/Profit Sharing Challenges.....	18

2.9.5 Misunderstanding and Lack of Standardization of IFB Concept.....	19
2.9.6 Lack of Supportive Institutional and Market links	20
2.10 Opportunities of Interest Free Banking.....	20
2.10.1 Opportunities of Interest Free Banking in Ethiopia	22
2.11 Empirical Review.....	23
2.12 Summary and Gap in the Existing Literature.....	25
CHAPTER THREE	26
RESEARCH DESIGN AND METHODOLOGY	26
3.1 The Research Design	26
3.2 Sampling Design	26
3.3 Data Collection Instrument	27
3.4 Source of Data.....	27
3.5 Data Analysis Method.....	28
3.5.1 Descriptive Analysis	29
3.5.2 Reliability and Validity.....	29
CHAPTER FOUR.....	31
DATA PRESENTATION, ANALYSIS AND INTERPRETATION	31
4.1. INTRODUCTION.....	31
4.1 Response rate	32
Table 4.1 Response Rate.....	32
4.2 Descriptive statistics	32
4.2.1 Demographic characteristics of the respondent	32
4.3 Description of Independent Variables (IVs)	35
4.3.1 Proper legal and regulatory frame work.....	35
Table 4.3 Frequency result of proper legal and regulatory framework.....	35
4.3.2 Limited Market- Based Financial Intermediations and Products.....	37
4.3.3 Sharia'a Experts and Man power	39
4.3.4 Misunderstanding and Lack of Standardization of Islamic Financial Concept.....	41
4.4 Opportunities of Interest free banking in Ethiopia.....	43
CHAPTER FIVE	46
CONCLUSIONS AND RECOMMENDATIONS	46
5.1 Conclusions.....	46
5.2 Recommendations.....	47
5.3 Research limitations and future research directions.....	49
References.....	50
Appendix A.....	52
Glossary of Interest Free Banking	52

LIST OF TABLE	Page
Table 3.1 Selected banks with window based IFB.....	28
Table 3.2 Reliability Statistics.....	30
Table 4.1 Response Rate.....	32
Table 4.2 Summary of Demographic Profile of Respondents.....	33
Table 4.3 Frequency result of proper legal and regulatory framework.....	35
Table4.4. Frequency result for Limited Market.....	37
Table4.5. Frequency result for Risk management challenges.....	39
Table4.6. Frequency result for Misunderstanding and Lack of Standardization.....	41
Table 4.7 Frequency result for Opportunities of IFB in Ethiopia.....	43

ACRONYMS AND ABBREVIATIONS

AAOIFI -Accounting and Auditing Organization for Islamic Financial Institutions

CBE – Commercial Bank of Ethiopia

FSA- Financial Services Authority

IBS- Islamic Banking Service

IFB – Interest Free Banking

IFI - Islamic Financial Institution

IFSB- Islamic Financial Services Board

IMF- International Monetary Fund

IS – Islamic Banking

LIBOR- London Inter-bank Offered Rate

NBE – National Bank of Ethiopia

NICD- Negotiable Islamic Certificate of Deposits

OIB- Oromia International Bank

OIC- Organization of Islamic Cooperation

PLS- Profit and Loss Sharing

R&D – Research and Development

SSB- Shari’ah Supervisory Board

UB – United Bank

Abstract

The main objective of this study is to examine operational challenges and opportunities of interest free banking in Ethiopia. Interest free banking was introduced in Ethiopia as an alternative to the banking industries within the existing conventional bank in window bases, and strictly operates in line with the principles of Shari'ah. However, its operations have been constrained partly by, legal and regulation framework, misunderstanding and lack of standardization, limited market, and sharia experts and man power. The study used descriptive methods of analysis, Primary data was used by preparing questionnaires to test stated research hypotheses and to answer the research questions. To achieve the objectives of the study respondents were drawn from one government banks and four private commercial banks since they started IFB financing and saving service. Data was collected through questionnaire by using random sampling from a sample of 180 IFB staffs 126 were properly filled and returned the questionnaires. The data collected from the questionnaire were analyzed using SPSS version 20 statistical tools such as percentages and frequency. The result showed that proper legal and regulatory framework is the major setback to the operation of interest free banking, lack of sharia experts and man power significantly lagged the operations of Interest free banking; limited market makes very limited provision for the operation of Islamic banking in Ethiopia; and these key findings show that a major setback to the operation of IFB in Ethiopia and above all, misunderstanding and lack of standardization of IFB concept are the major challenges of IFB operation in Ethiopia. Further the finding of the study showed that interest free banking is an effective mechanism to subjugate the liquidity and inflation problem. Thus, regulatory governance and banks should give more emphasis for the challenges that they face on the operation to have those mentioned opportunities and inclusive growths.

Key words: Interest free banking, Islamic finance, Operational challenges of IFB, Opportunities of IFB

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The challenges and opportunities of Interest free banking have been studied by different scholars in relation to its rapid growth and become increasingly significant in financial sector in the World.

Interest free banking is a banking system that compliance with Islamic Law – Shariah. The rules and practices under Interest free banking are in accordance with the primary sources of Shariah Law. The growth of Interest free Banking partly reflects demand from Muslim population and non-Muslim clients for Interest free deposit facilities and fund management services which involve shari’ah compliance. At the same time Islamic financing methods are viewed as a challenge on the operation by Ethiopian commercial bankers, many of whom have sought to get involved in this growing industry. In client driven societies there is willingness by those in financial services to listen and learn from the experiences of Islamic banks, which in the longer run may bring a major breakthrough for Islamic banking at the retail level in the country. (Usmani, 2005)

Interest free banking has grown rapidly over the past decade, and its banking segment has become systemically important in a dozen countries in a wide range of regions. Islamic finance is projected to continue to expand in response to economic growth in countries with large and relatively unbanked Muslim populations. It is also fueled by the large savings accumulated by many oil-exporting countries that are seeking to invest in Shari’ah-compliant financial products. (IMF Staff Team, 2015)

In some countries such as Pakistan, Iran and Sudan all banks are operating according to Islamic financial law but in some other countries such as Ethiopia, Bangladesh, Egypt, Indonesia, Jordan and Malaysia Islamic banking services are provided through conventional banking. There is big movement started in the Western countries especially United Kingdom,

Australia and United State to open Islamic banking in full-fledged model. In Ethiopia more than nine banks have the license to provide Islamic financial services on window basis and according to Sha'riah law.

Islamic banking is based on Islamic Sha'riah Law which provides all solutions of financial problems. According to Islamic law interest is totally prohibited in Islam because interest has lot of bad effects on society such as their earning capacity, purchasing power and increase poverty, unequal distribution of wealth and credit crisis in an economy. (Shanmugam, Perumal and Ridzwa, 2004)

In Islamic financial law there are some methods of financing such as Musharaka, Murabaha, Mudaraba and Ijarah which provide all the contractual details of the business and some contracts are based on profit and loss sharing schemes. Islamic financial system is based on risk sharing between parties and there is not wholly burden on one contracted parties. Interest free banking is not only for Muslim community because it provides moral and more ethical concept of financing and investment. Interest free banking has some operational challenges in the Ethiopian financial sector because the financial system is more attractive to conventional banking.

Interest free banking offer opportunities for flow of cross border capital, financial market deepening, financial inclusion in both Muslim minority and majority countries, enhancing product offering, promotion of monetary policy effectiveness, employment opportunities, etc. and there are also a lot of operational challenges on the IFB services, there is a serious shortage of scholars and qualified managers. Unfortunately the managers are not well trained in the use of Islamic financial practices Islamic banking is facing the problem of legal system because Islamic banking not yet proper regulated due to this there is possibility to create tension between Islamic banking and regulators (Karbhari, Naser and Shahin, 2004).

1.2 Statement of the problem

No banking products were available to serve the Muslim community and non-Muslim population who do not want interest until 2011. Even if the National Bank of Ethiopia (NBE) has launched an Interest Free Banking (IFB) directive, there is still a need to develop an adequate legal framework to effectively implement and capitalize on a prosperous IFB sector in Ethiopia; however, there has been no concrete work conducted for a proper roll out of these products. Currently, the directive is very broad and does not provide any specificity in terms of product lines, rules and regulations to ensure that the products developed by financial institutions are truly in line with Sharia law.

Starting from 2011 there is an improvement and development in IFB system. Currently above nine banks have the license from NBE and start promoting IFB service and accepting non-interest deposits but five of the conventional banks are involved in financing. The finance given by those banks are, Profit and loss sharing (murabah), a profit sharing joint venture (musharaka), a profit sharing agreement (mudaraba), supplying industrial products to clients order (istisna), a globally recognized mode of leasing (ijara) and other services.

The Ethiopian banking and financial rules and regulations as it was issued to guide the conventional banks operating in the country and so not considered the IFB service due to this Interest free banking is facing some difficulties in the way of its operational progress. In other word these problems has great operational challenges for Interest free banking.

Interest free banking faces significant operational challenges as a result of having its own sharia experts and well trained man power, on the one hand, and operating in a tax, legal and regulatory environment that was originally designed for conventional banks, on the other hand. (Karbhari, Naser and Shahin, 2004)

There are a lot of studies that have been conducted about the challenges and opportunities of Interest free banking; however, one studies by researchers (Louis S. Nkwatoh, hmed Mallum, 2014) about operational challenges of interest free banking studied in Nigeria non interest banking particularly JIAZ International Bank, the findings show that operational challenges

like legal framework, moral hazard, man power and religion are a major setback to the performance of Islamic banks in Nigeria and above all, competition with conventional banks affects the operations of JAIZ bank significantly. On this study the researcher focus only on the operational challenge of IFB and its opportunities in Ethiopian banks. Due to the researcher couldn't find any studies in the subject matter.

This study is, therefore, aimed at evaluating the operational challenges of IFBs and its opportunities in the selected conventional banks those started IFBs in window bases.

1.3 Research Questions

The study was conducted to answer the following research questions.

- Is the legal and regulatory system becomes the operational challenge of IFB in Ethiopia?
- Is the limited market-based financial intermediations and products becomes the operational challenge of Interest free banking in Ethiopia?
- Is interest free banking has enough *Sharia'a* experts and man power?
- Is misunderstanding and lack of standardization of Islamic financial concept becomes the operational challenge of IFB in Ethiopia?
- What benefits will Ethiopia obtain from the establishment of Interest Free banking

1.4 Research Objective

The study has the following general and specific objectives.

1.4.1 General objective

The general objective of this study was to identify the operational challenges of IFBs and its opportunities in Ethiopian.

1.4.2 Specific objective

This study specifically strived to achieve the following special objectives. In general the study was trying;

- To evaluate the challenge of legal and regulatory system on IFB operation.
- To analyse the challenges of limited market and products on IFB operation.
- To evaluate lack of sharia experts and man power on IFB operation.
- To examine staff awareness about standard of Islamic financial concept.
- Lastly but not least, the study also tries to identify what benefits will Ethiopia obtain from the establishment of Interest Free banking.

1.6 Significance of the Study

The findings of the study have theoretical and practical contributions. Theoretically, the findings of this study will fill an important gap to serve as a reference material to the existing body of the literature and initiate other interested researchers as a starting point to carry out more extensive studies in the area.

On the practical side, this study is expected to help to acquire knowledge and practical experience to the researcher, bank managers (both governmental and private banks), bank policy and decision makers to identify and understand the operational challenges of Interest free banking and its opportunities.

1.7 Scope and Limitation of the Study

1.7.1 Scope of the Study

The main focus of the study was to identify operational challenges of IFB and its opportunities in Ethiopian commercial banks. Therefore the scope of the study is restricted on identifying the stated operational challenges and opportunities of IFB on the selected commercial banks (Oromia international bank S.C, Commercial Bank of Ethiopia, United bank S.C, Wegagen Bank S.C and Abay Bank) found in Addis Ababa that have been operating in the industry over the period 2013-2018.

1.7.2 Limitations of the Study

The potential limitation in conducting this study includes but not limited to; lack of relevant and exhausted related research works on the subject. The other important limiting factor that is worth of mentioning lies with the participants of the study. Most of the participant's don't have clear understanding about the intents of the study and there is inherent risk of extreme reservations in full participation, if any, due to the high sensitivity and versatility when it comes to religious matters, especially this time around.

1.8 Organization of the Study

The main purpose of the study is to identify operational challenges of IFB and its opportunities in Ethiopian Commercial banks. And it organized as follows. Chapter one contain background of the study, statement of the problem, research objectives, hypothesis of the study, significance of the study, justification of the study, limitations and scope of the study. Chapter two provide a literature review informing the reader of what is already known in this area of study. Chapter three: This chapter describes the data, identifies the sources and explains the methodology which was employed in the study. The results of the different methods used and an analysis of the results are presented in chapter four. This is followed by the conclusion and recommendations in chapter five.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

This chapter explores the existing literature on the challenges and opportunities of interest free banking. The chapter reviews theoretical and empirical literature on different type of challenges. The chapter also explains the research gaps.

2.2. Theoretical Literature

2.2.1 Concepts of Interest Free Banking

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

Islamic banking appeared on world forum as a prominent player over two decades ago. But actually many principles of Islamic banking system have been generally accepted all over the world for centuries rather than decades Islamic financial system is existed in Muslim community in different shapes according to situation of time. Actually Islamic financial system has a capability to fulfill the society requirements in respectable way. Islamic banking is a growing sector with its diversity in different segments and spectrum. It caters to religious Muslims in Muslim's societies as well as in countries where Muslims are in minority. In addition, it is a broad standard: non-Muslim individuals and communities that seek ethical fi-

nancial solutions have also been attracted to Islamic banking. It is clear from banking practice that Islamic banking is equally popular in all communities (Iqbal, M., 1998)

It is clear from above statements that Islamic banking is not only Islamic or specific banking but actually it is a system which provides more ethical and moral concept of financial issue as well as it is really helpful to create a peaceful, economically prosperous and welfare society.

The Organization of Islamic Conference (OIC) defined an Islamic banking as “a financial Institution whose statutes, rules and procedures expressly state its commitment to the Principles of Islamic Shariah and to the banning of the receipt and payment of interest on any of its operations” (Hassan, 1999).

According to this statement it is clear that interest is fully prohibited in Islamic law due to its bad effects on human being and more badly effects on overall society and economy. In an interest based economy a trend arises that rich people create the methods to increase their wealth through effecting the middle and lower classes. In interest based economy the middle class cannot contribute positively in economic system then gradually the economy travel toward financial crises such as credit crunch.

An Islamic bank is an intermediary and trustee of other people’s money with the difference that it shares profit and loss with its depositors. In practice the most Islamic banks have an organizational set-up very matched and similar to their conventional counterpart banks (Dar and Presley, 2000). “Islamic banking is phenomenally profitable because, although it’s underlying funding mechanism is the same as conventional banking, its default experience is better, and its charges higher and less transparent” (Cook, 2006).

It is resulted from above statements that Islamic banking is not totally different from Conventional banking. They are doing same practice such as saving deposits and consumer Finances but there are some fundamental differences of its practice and objectives. Islamic Banking is interest free and its main objectives are the equal distribution of wealth, decreasing the poverty and increasing the investment opportunities. It is very beneficiary for Muslim population who want to solve all their financial matter according to their religion. Because a number of

Islamic and some high street commercial Banks from all over the world offer products and services that are according to Sha'riah Compliant. "Although the western media frequently suggest that Islamic banking in its present form is a recent phenomenon, in fact, the basic practices and principles date back to the early part of the seventh century" (Shaista, W. & Umadevi, N. G.,2013)

2.3 Evolution of Islamic Banking

The origin of Islamic banking as a major player in the financial domain was in the early 1970's. But the rules and regulations governing Islamic banking system has been present in the world for many centuries.

During the middle ages, Islamic finance was popular and was widely accepted and practiced. It helped in furthering the trade and business in the Muslim world. The Islamic merchants began to play a very important role in the European region (Mediterranean, Spain and Baltic States).

Islamic finance has become a global system spreading as far as Asia, the Middle East, and the Western world. Islamic banking is not limited only to the Muslim nations in the Middle East but also exists in the developed economies such as USA, Europe, and the far East. Today, more than four hundred and fifty (450) Islamic banks are operating from China to USA, having assets in excess of one trillion US dollars.

2.4 The Principles of Interest free banking

The principles of Interest free banking are based on Islamic law, known as sha'riah, which mean:

2.4.1. Interest (riba)

Interest cannot be paid or received on transactions in any case where money is exchange for money, because money by itself does not have any value unless employed in business according to Islam.

Prohibition of riba (interest)

Many Muslim scholars and some western thoughts believe and still considering that just interest free banking is as an Islamic banking. Actually interest is fully prohibited in Islam that is proved in Qur'an and sunnah. "the interest that you give in order to increase the wealth of the people, does not increase in the sight of God; and the zakat that you pay in order to win God's approval, its payers do indeed increase their wealth.

It is concluded from above statements that in Islam there is no room for interest. Interest is totally prohibited in Islam. In interest-based economy the depositors want to get more interest and want to increase their wealth through interest. They are not taken part in investment activity it leads to collapse and credit crunch. On other hand the banks charge high rate of interest on loan, it creates the difficulties for poor people of the society and leads to maximize the wealth of industrialists and giants. (shafi and usmani, 1997)

2.4.2. Gharar and Maysir

Transactions must avoid uncertainty (Gharar), speculation (Maysir) or anything that could lead to the unjust enrichment or unfair exploitation of one of the parties to a contract. In case of speculation the big investors and industrialists turn the economic financial system toward their own and personal benefits.

2.4.3. Unethical businesses

Transaction cannot be made that involve prohibited products or activities, such as alcohol, illicit drugs and tobacco because Islam wants to develop an ethical and friendly environment in the society (Imeson, 2007).

2.5 The Fundamental of Interest Free Banking and Finance

Islamic commercial law is actually based on four basic principles. The fundamental of first Islamic business principle is profit and loss sharing and the second is based on fixed service

Fees and charges and third is based on free of cost and no charges. The other principles are changing with the situation of the business and its operation (Bellalah and Ellouz, 2004).

Musharakah (Partnership Finance)

Is a contract in which the bank and the industrialist contribute jointly to the capital of a company or project to make a profit. Profit and losses are shared between the parties on agreed term and condition of the contract.

Mudarabah (Trust Financing)

Is a contract, in this contract it is the responsibility of the bank provides all the capital, the partner contributes commercial efforts, professional skills and experiences. Finally, the bank receives a predetermined proportion of the profits. In the case of a loss, the bank bears all the financial loss whilst the manufacturer goes unrewarded (Rob, 1992). It is concluded that this system encourage the individual to participate in financial activity and prove himself as an active part of society (Kettell, B. 2011).

The third principles and the free charges among the principles:

Murabaha (Cost-plus financing) is a contract in which the bank informs the industrialist about the acquisition cost of a good and negotiates with him the profit margin. It is one of the most popular modes used in Islamic banking system in different countries to promote interest-free transactions.

Bai-mua'jjal (deferred payment sale) is a deferred payment sale contract which is traded without additional costs.

Ijara (Leasing) The Ijara is a rent contract by which the owner of the good rents it to another party.

After that the latter can purchase it and rent is reduced until the good become the possession of the client (Bellalah and Ellouz, 2004). Nowadays the Home Finance and Islamic mortgage are based on the concept of Ijara and it is very successful tool in Islamic financial system.

Quard Hassan: - In Islamic financial system the customers who are facing financial crises or unpredicted Expenditure banks provide welfare loan without paying any fees or interest (Peter, 1992). According to Rob (1992) Islamic banks can raise the funds through sale of shares to public and further through three main deposit accounts such as investment deposits, saving deposits and current deposits.

2.6 Shariah Advisory Council/ Consultant

Islamic banks and banking institutions that offer Islamic banking products and services (IBS banks) are required to establish a „*Shariah*“ Supervisory Board (SSB) to advise them and to ensure that the operations and activities of the banking institutions comply with „*Shariah*“ principles.

A number of „*Shariah*“ advisory firms have now emerged to offer „*Shariah*‘ advisory services to the institutions offering Islamic financial services. Issue of independence, impartiality and conflicts of interest have also been recently voiced. The "WDIBF" World Database for Islamic Banking and Finance has been developed to provide information about all the websites related to this type of banking.

2.7 The three Legal Maxims of IFB

- i. **General Permissibility** : Everything is allowed unless specifically prohibited
- ii. **PLS (Profit and loss sharing)** : The one who takes the risk has the right to share in the profit
- iii. **Asset Backed Financing** : If you want the asset financing then you have to show the asset

2.8 Islamic /IFB Mode of operations

➤ **Dedicated Window Model:**

- Units within a conventional bank that exclusively offer IFB services' (**NBE's Directive No.SBB 51/2011**);
- Refers to conventional banks that offer Islamic banking products and services using their existing infrastructure, including staff and branches.
- Usually assurance is given for the segregation of client's funds with any interest-based funds. E.g. ABSA Islamic Bank south Africa, Citibank, HSBC, Lloyds of London

➤ Dedicated Branch Model

➤ Subsidiary Model:

➤ Fully Fledged Islamic Bank Model

2.9 Operational Challenges faced by Interest free banking

Interest free banking is in infant stage in Ethiopia economy and some of the potential operational challenges should be taken up to make Islamic banking more productive in every segment of the economy and society. There is need to make a clear and transparent system of general Islamic banking which concerned to all sectors of society and economy in order to address the challenges and threats of the future needs of the financial sector. Islamic banking has been facing so many challenges since its origin. Islamic banking has been in transition and development phase in different countries for the last two decades. Islamic banking industries have always suffered with the issue of different opinions of Islamic scholars, suppose a product or practice may be accepted to one Scholar, could be considered un-Islamic by another scholar. (Khalaf, 2007)

In Islamic banking system there is a serious shortage of scholars and qualified managers. Unfortunately the managers are not well trained in the use of Islamic financial practices (Iqbal, Ahmad and Khan, 1998). Islamic banking in western countries is facing the problem of legal

system because Islamic banking not yet proper regulated due to this there is possibility to create tension between Islamic banking and regulators (Karbhari, Naser and Shahin, 2004).

2.9.1 Legal and Regulatory Challenges

It is fact that Islamic banking is not well regulated at the moment because they have not a strong branch network. (www.islamic-bank.com). And as same, what's most challenging about working in this area is that interest-free banking is not progressing at the same pace as market demand. This is due to a lack of knowledge around regulations. Banks are unclear how to solve legal disputes that arise from interest-free finance, and there is a still a gap in knowledge about how to design appropriate products. It is under working to build the capacity of staff to design financial products and how to evaluate the market and, working with the Ethiopian government to establish an interest-free finance advisory board that will assist the industry to navigate regulations.

Currently Islamic banking is facing the challenge of the new mode of conventional banking in opening of Islamic banking window. It will improve the services of Islamic banking but there is a need that Islamic scholars work hard to maintain the priority of Islamic Sha'riah Islamic banking is still highly promising as compared with conventional banking, and this is an immense factor contributing to the range of challenges IFB are currently facing;

Due to the novelty of Islamic banking systems, their legal and regulatory frameworks are still quite complex and un-standardized. Therefore, they tend to follow varied accounting and other practices with no universally recognized standards. Some of them follow International Accounting Standards (IAS), others adhere to standards issued by Accounting Auditing Organization for Islamic Financial Institutions (AAOIFI), while some adopt accounting standards prevalent in their local markets (Khalid and Amjad, 2012).

2.9.1.1 International Regulating Bodies

In addition to the country specific banking and IFB regulations and guidelines, there are a couple of international Islamic finance agencies responsible for providing regulations, standards and procedures for enforcing and regulating the soundness of Islamic banking industry.

This section will give an overview of these key bodies, their role and also the list of countries which has adopted these standards either at the regulatory level or on a financial institution's level to follow the best practices in Islamic banking and finance.

2.9.1.2 International Financial Services Board (IFSB)

IFSB was launched in 2002 in Kuala Lumpur and serves as an international standard setting body that provides prudential standards and guidelines for regulatory and supervisory agencies to ensure soundness and stability Islamic Financial industry including: retail banking, capital markets and Takaful (Islamic insurance). The IFSB has:

- 13 standards
- 5 guide notes
- 1 technical note

As of September 2014, IFSB members comprise of 184 members from 41 jurisdictions, including 32 members from the African continent. IFSB has 55 regulatory and supervisory authorities, 8 international/intergovernmental organizations and 121 market players, professional firms and industry associations.

Several non-predominantly Muslim countries have adopted IFSB rulings including: China, Hong Kong, Japan, Korea, Luxembourg, Singapore and Thailand.

2.9.1.3 Accounting and Auditing Organization for Islamic financial institutions (AAOIFI)

AAOIFI is responsible for developing and issuing standards for the Islamic finance industry. AAOIFI has over 200 members in more than 40 countries. Members include regulatory and supervisory authorities, international/intergovernmental organizations and market players, professional firms and industry associations.

- Countries adopting AAOIFI include: Kingdom of Bahrain, Dubai International Financial Centre, Jordan, Lebanon, Qatar, Sudan and Syria.
- Countries with guideline based on AAOIFI: Australia, Indonesia, Malaysia, Pakistan, Kingdom of Saudi Arabia, South Africa and United Kingdom.

AAOIFI standards have introduced greater harmonization among Islamic finance actors across the world (Zaineb Sefiani, 2014)

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

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

The implementation of financial products and adaptability to technology is low and above all, the necessary expertise and institutional capacity for Research and Development (R & D) that is not only necessary for the realization of their full potential, but also for its very survival in this age of fierce competition, sophisticated markets and an informed public is absent.

There is still an acute shortage of skilled human resources in Islamic banks and inadequate training is given to staff on how to incorporate fundamental Sharia'a- compliant Islamic banking principles. Most importantly, there is an evident scarcity of competent Sharia'a experts in the Islamic banking industry, with a small group of experts serving on several Sharia'a boards of Islamic banks worldwide.

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

2.9.3. Concentrated Banking: Limited Risk Management Functionality

IFB face another crucial challenge in improving risk management strategies and corporate governance because of they adhere to *Sharia'a* principles. They are currently exposed to all types of risk including those faced by conventional banks and those unique to IFBs. The assets and liability structures of IFB have unique risk characteristics as a result of the Islamic banking model evolving into pure Islamic modes and instruments as previously discussed. (Ikha and Abdullah, 2011)

Hence, while the conventional banks guarantee the capital and rate of return, the Islamic banking system, based on the principle of PLS, cannot, by definition, guarantee any fixed rate of return on deposits. In some cases the capital is not guaranteed either, because if there is a loss it has to be deducted from the capital. As a result, Hassan (2009) confirms that ibs face not only the regular risks encountered by conventional banks but they also face other risks as a result of their unique asset classes and liability structures.

Consequently, IFB are haunted by the chronic problem of excess liquidity, because they carry about "40 percent of surplus cash & other liquid assets in comparison to CBs due to the serious dearth of long-term Sharia'a-compliant investment tools and avenues."(Khan and Bhatti, 2008)

2.9.4. Cash Requirements/Profit Sharing Challenges

Though the notion of Islamic banking in Ethiopia had resonated within the 2011s and has ramified to some part of the country in Ethiopia, its practice is still very new to their entire public and as such, individuals are risk averse in investing in such a venture. This has also been fueled partly by the national bank of Ethiopia. For instance, NBE require initial capital or cash requirement for License of banks is birr 500 million. Hence, one would see hardly business men/money lender putting such money on uncertainties just in name of Quaran' and Hadith of the Prophet (Momoh, et al 2011). The profit/loss formula is only known to the proprietors and managers of Islamic banks which may generate corrupt practices by the some unprincipled personnel.

2.9.5 Misunderstanding and Lack of Standardization of IFB Concept

Islamic financial institutions are compliance to Shariah Law; it is not only applicable for Muslims. Under the study of Gerrard and Cunningham (2003) there are only few numbers of Muslims aware to the Islamic banking operation while there is almost none of non-Muslims have a clear concept for the Islamic finance culture. It proves that the customer awareness on Islamic finance sector is unfavorable, the education provided to customers regarding to the Islamic banking products are still insufficient. According to the research done by Doraisamy, Shanmugam and Raman (2011), the amount of residents in Sungai Petani who are familiar with Islamic banking operation are still low and the promotion about Islamic banking still unoptimistic.

Some peoples may not differentiate the operation concept between conventional and Islamic financial institutions and they deemed that Islamic banking is merely a change in name without any others special features. They argue that the “profit rate” used under Islamic banks is just a substitution for “interest rate” under conventional banks.

Usually, most of the conventional banks offered the Islamic product based on different terms for example Wadiah or saving account. Most of the window or subsidiaries will use the familiar terms for market the products.

One of the major reasons that causing the concept of Islamic financial system become ambiguous is because of the inconsistent point of view among different scholars. Based on research of Venardos (2012), there are four common methodologies applied under Islamic financial institutions, which are: *ijtihad* (interpretation by using existing sources), *ikhtiyar* (choice), *darura* (necessity) and *hila* (legal artifice). The application of different methodology will lead to the inconsistent of *fiqh* rulings.

Due to the ambiguous concept for Islamic financial institutions, there are insufficient experienced professional in Islamic finance sector which retard the development of Islamic financial institutions. Research paper of Iqbal, Ahmad and Khan (1998), stated that there is an extreme insufficient of scholars available, who obtain working experience of both Islamic *fiqh*

and modern economics and finance. In addition, many existing employees under Islamic banking are not been trained well in the use of Islamic financing modes. This leads the development problem of Islamic financial institutions occur.(Nur Aqilah Zainordin,2016)

2.9.6 Lack of Supportive Institutional and Market links

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

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

So, adequate financial mechanism still has to be developed, without which financial intermediation, especially the risk and maturity transformation, will not be performed properly

Moreover, however well integrated it may be, any system cannot thrive exclusively on its built-in elements. It has to depend on a number of link institutions and Islamic banking is not an exception to this rule.

They also need research and training forums in order to promote entrepreneurship amongst their clients. Such support services properly oriented towards Islamic banking are yet to be developed in many countries.

2.10 Opportunities of Interest Free Banking

According to a recent study by the IMF in the year 2010, which compares the performance of Islamic banks and conventional banks during the recent financial crisis, it was discovered that the Islamic banks, on average, showed strong resilience during the financial crisis over its conventional counterparts. Broadly, IFB offer opportunities for flow of cross border capital, financial market deepening, financial inclusion in both Muslim minority and majority coun-

tries, enhancing product offering, promotion of monetary policy effectiveness, employment opportunities, etc.

Many countries stand to benefit from flow of cross border of financial resources not only from the traditional sources; Western Europe and the United States, but from oil-rich Middle East – home to vast investment resources, and Asian countries – with Malaysia as the global hub of Islamic finance, as well.

Akin to the above is the opportunity for financial market deepening which the cross border capital flow could help to promote. Analysts have argued that the current market capital market condition portends a lot of opportunities for significant price-adjustment of stocks, signifying more opportunities for investment in stocks, but, constraints in the area of technology efficiency, incentives, compulsory listing, capacity building, new products in offering, full disclosure, among others, are said to be critical in driving the market. Evidences, for instance, in 2010 show the private sector through mergers and acquisition raised 86.2 percent through the capital market while total bond issue stood at 7.2 percent. These facts show that both the private sector and the government have great capacity to cajole and absorb the opportunities in the global market.

The extent of financial inclusion in a country speaks of access to financial services by its citizens. Financial inclusion is the provision of a broad range of high quality financial products (such as savings, credit, insurance, payments and pensions) which are relevant, appropriate and affordable, to serve the needs of the entire adult population and especially the low income segment.. Once financial access is enhanced, economic activities such as production, employment, distribution, consumption, etc., will certainly increase and economic growth and development would arise.

The operation of IFB enriches the product mix and offer wide range of financial services. For instance, Murabaha mode of asset financing, Musharakah and Mudarabah deposits accounts, Ijara financing via asset leasing, purchases and supply arrangements through Salam, Istisna and Istijrar, are all new additions to the existing menu of banking products and services. The-

se services, however, bear the unique sign of profit and loss sharing which is lacking in the conventional banking operations.

Interestingly, financial market analysts from all extractions and across religious divide are gradually familiarizing with these concepts and terminologies. At the global scene, global performance indicators have been developed for tracking the performance of Islamic financial services/products.

In the preceding paragraph, IFI's are said to be capable of wooing the non-bank public to accept banking services that are compatible with their religious beliefs and way of life. Once this is achieved, it offers great opportunity for the apex bank to have a full grip of monetary policy variables; monetary policy rate, money supply and credit availability. On the contrary, for instance, high degree of financial exclusion results in high proportion of money outside the bank and equally outside full control of the Central Bank. Last but not the least is the fact that the presence of IFB offers opportunities for employment to practitioners in the banking industry and to new entrants as well. (S. Usman R.Aliyu, 2012)

2.10.1 Opportunities of Interest Free Banking in Ethiopia

The prospect of Islamic Banking looks very bright. Ethiopian Muslims and non-Muslim community everywhere want Interest free Banking. In addition, Ethiopia having more than 35 million Muslims offers huge opportunities to exploit. The size of the market will be very large as majority of Ethiopian Muslims, in the name of religious faith, are looking for interest free financial services. It is pertinent to mention here that Islamic banking is not meant for Muslims only but non-Muslims may also avail the benefit of it. And it is feasible to have a parallel banking system: one based on *Sharia* along with a conventional one.

The Growth and Transformation Plan, third five year economic plan, envisages inclusive growth with development in all sectors of the economy. Islamic banking is an effective mechanism to subjugate the liquidity and inflation problems while allowing inclusive growth. For real inclusive growth, which requires increase in income and employment should be ensured for all segments of the society.

If Islamic banking is introduced, the inadequate labor capital ratio, for informal sector workers and farmers associated with agriculture and manufacturing industries could be resolved through equity finance, which might be a revolution in our agriculture and unorganized sector. With improved labor capital ratio, our vulnerable workers associated with agriculture and unorganized sector might be able to compete effectively with the formal sector workers. Thus Islamic Banking may financially empower majority of Ethiopian workers and farmers.

Moreover, with introduction of Islamic banking, Ethiopian government will certainly gain diplomatic advantages to make financial dealings with Muslim dominated nations especially to attract trillion dollars of equity finance from the gulf countries. Finally, Islamic banking should not be regarded as religion based banking business, but could be profitably used to resolve issues pertaining to economy (Mohamed Muhumed, 2012)

2.11 Empirical Review

There are many studies undertaken relating to challenges and opportunities of interest free banking. The Islamic finance and banking literature shows that many scholars have tackled the subject matter of the Islamic finance challenges and opportunities.

Wilson (2000) examines the growth of Islamic finance in United Kingdom. He supposed that the Islamic finance partly reflects demand from Muslim resident and non-resident clients for Islamic deposit facilities and fund management services which involve shari'ah compliance. The study is focused on the Islamic financing methods as a challenge and opportunity by Western bankers. The results of the study indicate that there are many challenges and opportunities faced by Islamic Banks in United Kingdom to increase their economic growth.

Al Maraj (2008) "Governor of the Central Bank of Bahrain discusses the need for Islamic banks to diversify activities, and he could identify the challenges that faces Islamic Finance as that investment banks are project-driven and do not have a steady source of revenue to tide them over any slumps in economic activity, the multiplicity of Shari'a boards and judge-

ments, Shari'a compliance and how to provide a satisfactory framework to assure investors and other stakeholders, accounting standards.

SunGard (2008) discusses the Islamic Banking and Finance growth and challenges ahead. It provides a long list of challenges such as competition, Demand for more expertise on Islamic finance, the immediate need for short-term money market investments and tools for liquidity management, Limited Islamic secondary markets, and various Sharia'h interpretations, Small number of participants and Slow or stagnant development of Islamic financial instruments.

Nur Aqilah Zainordin.(2016) conducts a questionnaire to investigate the challenges facing the development of Islamic banking in Kenya. His findings consider the Legal Support as most challenge as Islamic law offers its own framework for execution of commercial and financial contracts and transactions.

Iqbal, Ahmad and Khan (2009) supported that legal challenges affected the development of Islamic banking and financial institutions as Islamic banking is lack of effective supervisory framework. It caused the prevailing system inefficiency and hence it deserves a serious attention. Legal challenges also exist when Ahmad Ibrahim (2004) found that commercial banking and company laws do not appropriate for the implementation of Islamic banking and financial contracts.

Haidi and Malik (2006) supported the statement of "Misunderstanding of Islamic financial concept." They stated that the first impression of Islamic banking is the fixed rate concept of a "halal" loan serves as the substitution for conventional loan.

Karbhari, Naser, and Shahin (2004) claimed that the difference Islamic cultures and societies within different country causing the interpretation of Shariah principles goes inconsistent among each of the Muslim schools. The inconformity towards the Shariah views and different methodologies make the concept of Islamic financial institutions become unclear.

The study of John Wiley and Sons (2011) proved this challenge. He found that Islamic financial intermediaries expose themselves to liquidity problem due to the lack of developed mon-

ey market and the shortage of short term investment securities such as treasury bills and marketable securities which offer limited capital risk with optimum returns.

Not only this, Archer and Karim (2006) also proved that the development of Islamic financial institutions is challenging due to the incompleteness of traditional financial instruments which applied to the Shariah Law. Unlike conventional banks, Islamic banks are prohibited to issue treasury securities to maintain liquidity. There are still no other corresponded alternatives to substitute treasury securities to carry out the liquidity function.

The discussion of Islamic banking and finance has a long history in the world but it is not the same in Ethiopia because the phenomenon of Islamic banking and finance is a new concept. And there have been very few studies conducted regarding operational challenges of interest free banking and its opportunities.

2.12 Summary and Gap in the Existing Literature

It becomes especially worthwhile to examine operational challenges and opportunities of Interest free Banking in Ethiopia since different outcomes are expected to conclude in this area. Although various survey studies have been conducted to assess the challenges and opportunities of interest free banking, most of the studies have been carried out on the overall opportunities and challenges and its competitiveness with that of conventional banks. Even though IFB seems to be familiar and highly demanded, there is a dearth of empirical study that examines the operational challenges and its opportunities in Ethiopia particularly. Therefore, this study makes an attempt to bridge this gap and elaborated the operational challenges and opportunities of IFB in Ethiopia.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

This section contains the research methodology to be employed in order to address the research objective. The chapter covers the research design, 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.

3.1 The Research Design

This study use explanatory methods of analysis. Primary data was collected with the help of questionnaires, while secondary data obtained from paper presentations, seminar papers, annual reports of the banks and journal articles.

3.2 Sampling Design

The target population consists of 340 employees of the selected banks specifically IFB departments and Sample size is the actual respondents from the total target population. Random sampling method was used for questionnaire distribution purpose among the randomly selected branches according to the sample size. To do so the researcher used the bank's yearly book and own survey for purpose of sample size determination. For this study, the sample size is determined based on a simplified formula (Cochran, 1963) equation 3 for calculating sample size for known population with a 95% confidence level. The result is 180 respondents.

Sample Size Determination

$$n = \frac{no}{1 + \frac{(no-1)}{N}} = \frac{385}{1 + \frac{(385-1)}{340}} = 180$$

Where:

n= the sample size

N= the population size

According to the calculation the recommended sample size for this study was 180 respondents.

3.3 Data Collection Instrument

According to many scholars, in the use of survey strategy, the main instruments used are self-administered/interviewer, administered or structured/unstructured questionnaires (Saunders et al., 2000; Cooper & Schindler, 2006; and Malhotra & Birks, 2007). They further agree that, generally, the questionnaire can be used for descriptive or explanatory study, and must have a good layout, unambiguous questions, complete items, non-offensive but relevant items, logical arrangements of items, and the ability to elicit willingness to answer in respondents. As a result, in this study, self-administered, structured questionnaires are used to collect data. The purpose of the questionnaire is to have insight into operational challenges of interest free banking and its opportunities in Ethiopia finally to collect some data on respondents' bio-data.

3.4 Source of Data

In conducting the research both primary and secondary data are used. The sources of primary data are from employees of interest free banking department, managers and supervisors of the five banks. The secondary data also collected and used to describe and elaborate the conceptual aspects of the Islamic banking and financing services and their applicability. In addition to this different websites, books written by various authors, bulletins released by foreign banks and national bank of Ethiopia, etc.

Currently the numbers of banks operating in Ethiopia banking industry are eighteen, as of January 2017, of which 9 banks has got the license to operate interest free banking on window bases under the conventional banks. Among this nine banks with license of IFB only

five were starting Islamic banking service in window bases with financing namely Oromia International Bank S.C (OIB), Commercial Bank of Ethiopia (CBE), Abay Bank S.C(AB) Wegagen Bank S.C(WB) and United bank S.C(UB) the rest like Abyssinia Bank, NIB Bank and Dashen bank start without financing.

Therefore, the target population of this study is 4 private commercial banks and 1 state owned bank (CBE) operating in the industry as of January, 2017, A sample size of 180 respondents will constitute from the population. All questionnaires will be administered to the staff of IFB department of Oromia International bank, Commercial bank of Ethiopia, United Bank, Wegagen Bank and Abay Bank. The researcher adopted the non-probability sampling technique because it provides a better opportunity for administering questionnaires directly and individually to the respondents.

Table 3.1 Selected Conventional banks with window based Interest Free Baking.

NO	Name of Banks
1	Oromia International Bank S.Co
2	Commercial Bank Of Ethiopia
3	United Bank S.Co
4	Abay Bank S.Co
5	Wegagen Bank S.Co

3.5 Data Analysis Method

The SPSS software is used to conduct data analysis. Data analysis involves the process of data entries, coding, checking and handling missing data. Reliability test is conducted to ensure that the measuring test is consistent in order to produce an accurate result. Demographic information of each respondent will be presented using percentage and frequency. Lastly, the independent variables which are legal and regulatory challenges, limited market-based finan-

cial intermediations and products, challenges of sharia experts and man power, and misunderstanding and lack of standardization of Islamic financial concept will be used to explain whether each of the respondent's responses affects the opportunities of IFB.

3.5.1 Descriptive Analysis

Descriptive statistics analysis such as frequency and percentage are used to calculate the background of respondents. Descriptive analysis is used to explain and describe the data that collected from respondents under the descriptive statistic. In this study, the researcher was used descriptive statistics to understand more about the relationship between the operational challenges and opportunities of Interest free banking.

3.5.2 Reliability and Validity

Validity refers to the extent to which your data collection technique or analysis procedures will yield consistent findings'' (Saunders *et al.* 2009: 156).

Cronbach's Alpha is used to measure the reliability coefficient in SPSS software. The Cronbach's Alpha testing was used by way of the most well accepted reliability test tools practical by social researcher. According to Sekaran and Bougie (2010), a questionnaire consider attain a high level of reliability when the value of Cronbach's Alpha exceed 0.70. The closer the Cronbach's Alpha value is to 1.0, the higher the internal consistency reliability of the questionnaire.

Cronbach's Alpha measures as below:

1. Reliability less than <0.6 considered poor.
2. Reliability in the range 0.7 is considered to be acceptable.
3. Reliability more than >0.8 are considered to be good

Reliability refers to the consistency, stability and repeatability of data collection instrument. For any measurement to be valid, it must first demonstrate reliability (Frey, Botan, and Kreps, 2002).

3.5.2.1 Pilot Test

To insure the reliability of this study, the following measures had been used by the researcher. In order to enhance the validity of the data collected, both qualitative and quantitative techniques were used. The population data base was taken from reliable sources and yearly book of each private bank under study.

Mainly the survey method was the strategy of the research and Cronbach's alpha should exceed the threshold of .70. Cronbach's alpha is a function of the average inter-correlations of items and the number of items in the scale.

To check the reliability, the questionnaires were pretested with 20 sample questionnaires. As a result, Cronbach's alpha showed a satisfying reliability, above 70%.

Table 3.2 Reliability Statistics

Challenges	Cronbach's Alpha	N of Items
Legal and regulatory	.727	5
Limited market	.754	4
LACK SHERIA EXPERT AND MAN POWER	.821	5
Misunderstanding & lack of std	.938	5

From Table 3.2, it shows that the result of reliability for the sample questionnaire is above 70%, which means the variables items in the questionnaire that use to test the items have proven the significant relationship towards this research objective.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1. INTRODUCTION

As mentioned in the previous chapters, the main attempt of this study is to identify the operational challenges and opportunities of IFB in Ethiopia. The research study was; use descriptive analyses. Data was collected through both primary and secondary sources. Therefore, this chapter presents the analysis and discussions for research findings obtained from the questionnaires and secondary data gathered from published annual reports. It presents the investigation results obtained from senior, head and managers of five selected private banks covered in the questionnaires. The discussion begins with the questionnaires' response rate followed by the descriptive statistics of the respondents related questions; like the gender, age, religion, profession level, education level and experience and training status of the employees. The results of the reliability analysis also reported.

Total of 126 Interest free banking employees from Oromia International Bank, Commercial Bank of Ethiopia, Abay Bank, Wegagen Bank and United Bank had contributed to this questionnaire survey.

Statistical Package for the Social Sciences (SPSS) was used to analyze the data that were obtained from questionnaire. The results show the analysis of the data analyzed method applied which includes frequency, percentage and reliability test.

4.1 Response rate

According to Sekaran (2001), a response rate of thirty percent is acceptable for most studies however in this study the response rate of the questionnaire was 70% which is sufficient enough.

Table 4.1 Response Rate

Position	Number of questionnaire	Number of returned questionnaire	Percentage of returned questionnaire
Manager	15	9	60%
Head	15	15	100%
Senior	123	102	82%
Total	180	126	70%

Source: Own Survey, 2018

4.2 Descriptive statistics

4.2.1 Demographic characteristics of the respondent

The demographic characteristic including age, gender, education background and occupation level, religion, experience and training towards the variables are summarized by descriptive statistics using frequencies and percentages.

The questionnaire requested limited amount of information related to personal and professional demographic characteristics of respondents. Accordingly the following variables about respondents were summarized and described in the subsequent tables.

Table 4.2 Summary of Demographic Profile of Respondents

<u>Gender</u>	N° of Respondent	% of Respondent
Female	22	17.5
Male	104	82.5
Total	126	100
<u>AGE</u>		
Under 25 Years old	8	6.3
25-35 Years old	94	74.6
36-45 Years old	17	13.5
Above 45 Years old	7	5.6
Total	126	100
<u>Education Qualification</u>		
Diploma	6	4.8
Bachelor Degree	62	49.2
Master's Degree	58	46
Total	126	100
<u>Professional level</u>		
Senior level	102	81
Head level	15	11.9
Manager level	9	7.1
Total	126	100
<u>Religion</u>		
I am Muslim	66	52.4
I am Non-Muslim	60	47.6
Total	126	100

Source own survey, 2018

Presenting the information of different demographic variables in the above table helps the researcher to see the nature of the demographic variable by obtaining information to analyze how close to the industry they are and their educational background.

Thus from 126 respondent 104 (82.5%) were male and the remaining 22(17.5%) were female, as we observe from the above response the majority of the staff are male which shows they are active participant in the new banking sector.

Majority of the employees in Interest free banking are aged between 25-35 years old (94, 74.6%), following by the range 36-45 years old (17, 13.5%) and under 25years (8, 6.3%). Those respondents above 45 years old are the least percentage among all, only occupied 5.6% compare to other age range. From the above result the researcher observes IFB sector is well performed by staff under 35years.

Moreover, among the 126 respondents, 62 (49.2%) of the respondents have Bachelor degree, following by 58 (46%) of them have master qualification, while the least 6 (4.8%) are respondents have Diploma. From the above response by the respondent most of the IFB staff are either degree holder or masters holder, least of them with diploma.

On the other hand, through the distribution of the questionnaire, most of our respondents are from senior level employee 102 (81 %) respondents, from head level are 15 respondent(11.9%) while the lower level from manager are only 9 respondent (7.1%). So we can conclude from the figure the service are handled majorly by senior staffs followed by the rest.

Last for the religion, there are 66 respondents (52.4%) from Islam and the remaining 60 (47.6%) are non-Muslim. As the researcher observes each IFB banks under the study most of their staffs are from Muslim religion this is because of thoughts that those Muslim staffs are familiar with the terms and the principles than those non-Muslim staff due to the reason all terms and names are derived from holy Quran and Sunnah. So as per the figure shown on this research there is no as such difference exist, so it could be said that being Muslim and non-Muslim does not have any effect on using and giving the services under the IFB.

4.3 Description of Independent Variables (IVs)

4.3.1 Proper legal and regulatory frame work

Table 4.3 Frequency result of proper legal and regulatory framework

N	PROPER LEGAL AND REGULATORY FRAMEWORK	strongly disagree		Disagree		Neutral		agree		strongly agree	
		(N)	(%)	(N)	(%)	(N)	(%)	(N)	(%)	(N)	(%)
1	IFB do not invest in industries with products and services involved (Alcohol, Pork and Gambling).	4	3.2	9	7.1	17	13.5	52	41.3	44	34.9
2	IFB is lack of effective supervisory framework.	6	4.8	15	11.9	12	9.5	49	38.9	44	34.9
3	Lack of effective prudential regulation is one of the weaknesses of the IFB industry in Ethiopia.	5	4	3	2.4	18	14.3	41	32.5	59	46.8
4	IFB has not devised their own practices and procedures to accomplish their banking activities.	8	6.3	3	2.4	7	5.6	47	37.3	61	48.4
5	The role of Shariah boards brings unique operational challenges to the governance of IFB.	8	6.3	20	15.9	7	5.6	43	34.1	48	38.1

Most of the respondents 96 (76.2%) they understand investing on product and service like Alcohol, Pork and Gambling industries are forbidden in IFB” This is consistent with the principles of Islamic banking which is based on Shariah compliant finance.

93 respondents (73.8%) agree that IFB in Ethiopia is lack of effective supervisory framework and it is one of the operational challenges of the prevailing system and deserve serious attention.

In addition those agreed effective prudential regulation is one of the operational challenges of the IFB in Ethiopia are 100(79.4%) respondents.

108(85.7%) respondents shown on the above table agreed on IFB has not devised their own practices and procedures to accomplish their banking activities; therefore it is one of the operational challenges for IFB because the respondents feel that IFB do not have their own practices and procedures.

About the role of sharia board 91(72.2%) agree that the sharia board brings unique operational challenges to the governance of IFB.

At present Interest free banking are working in many Muslim and non Muslim countries without proper legal cover.

In general, legislative needs for Interest free banking can be minimized by legislating the Shari’ah principles and the Shari’ah restrictions for contracts, while leaving practical details for adjudication by the proper legal frame work. Nevertheless, attention will also have to be paid to the following and similar other points.

Murabahah financing means purchase and resale, i.e. two trading transactions. This need not be seen as such for sales tax purposes because Islamic banks do not buy things under financing for their personal needs. Registration requirements associated agreements need to be simplified as the associated costs may impede lease financing. There is also need for special legal cover in order to facilitate and implement musharakah (partnership) agreements by Islamic

banks. Adjudication of recovery of bank receivables is presently interest-based. Its alternatives need to be developed and provided for in the law.

One issue that will continue to be relevant in the foreseeable future is prospect of Islamic banks working in the prevalent interest-based framework. It is obvious that Islamic financial instruments and their documentation and accounting requirement would be different. Therefore, the room for putting Islamic financial norms into practice in the existing framework would be limited. This, in turn, implies that Ethiopia should consider providing separate legal cover for Islamic financing.

As the data on the above table shows, the findings of this study supports what has been reported in Islamic banking literature as one of the main problems facing Islamic banking worldwide and also similar with the study by Kinyanjui (2013) findings consider the Legal Support as most challenge as Islamic law offers its own framework for execution of commercial and financial contracts and transactions.

4.3.2 Limited Market- Based Financial Intermediations and Products

Table4.4. Frequency result for Limited Market- Based Financial Intermediations and Products

N	Limited Market	strongly disagree		Disagree		Neutral		agree		strongly agree	
		(N)	(%)	(N)	(%)	(N)	(%)	(N)	(%)	(N)	(%)
1	There are no much choices on IFB products compare to Conventional banks.	33	26.2	13	10.3	23	18.3	28	22.2	29	23
2	IFB exposes themselves to liquidity problem due to the lack of developed money market and the shortage of STI	24	19	14	11	12	9.5	35	27.8	41	32.5
3	There is incompleteness of traditional financial instruments in Islamic banking.	41	32.5	26	20.6	6	4.8	26	20.6	27	21.4

4	The major difficulty to develop Interest free banking is because of the limited financial instruments.	46	36.5	14	11.1	2	1.6	29	23	35	27.8
5	Creation of a larger size of local Islamic liquidity market become operational challenges due to the smaller economies of scale compared to conventional banking industry.	5	4	5	4	12	9.5	63	50	41	32.5

There are 104 respondents (82.5%) claimed that the “creation of a larger size of local Islamic liquidity market become operational challenging due to the smaller economies of scale compared to conventional banking industry.”

46(36.5%) respondents disagree that “there are no much choices on IFB products compare to Conventional banks”, they think that sufficient product are exist but the major obstacle is legal and regulation has no direction how to carry the service.

However, 60 respondents (47.1%) disagree that “the major difficulty to develop Islamic banking is because of the limited financial instruments.” Respondents thought are without having interest-free money and capital market, IFB will not have adequate instruments to meet the pre-condition for liquidity management and effective maturity transformation.

4.3.3 Sharia'a Experts and Man power

Table4.5. Frequency result for lack of man power

N	Sharia'a Experts and Man power	strongly disagree		Disagree		Neutral		Agree		strongly agree	
		(N)	(%)	(N)	(%)	(N)	(%)	(N)	(%)	(N)	(%)
1	IFB has not enough man power who are cable in adaptability to technology	14	11.1	9	7.1	21	16.7	42	33.3	40	31.7
2	IFB has expertise and institutional capacity for Research and Development (R & D) in Ethiopian banks	25	19.8	15	11.9	32	25.4	30	23.8	24	19.1
3	Without an efficient Sharia'a experts and Man power operating within the sector may not continue to grow IFB meaningfully.	5	4	12	9.5	18	14.3	41	32.5	50	39.7
4	IFB are hunted by the chronic problem of expertise to the sharia compliant service.	8	6.3	13	10.3	22	17.5	37	29.4	46	36.5
5	IFB has challenges in developing innovative services and products due to well trained employee and expertise.	8	6.3	40	31.7	7	5.6	43	34.1	28	22.3

82(65%) of the respondent agreed that not enough Sharia'a experts and Man power exist in Interest free banking which understand the moral and religious implications with the business ventures and in adapting technology , because the personnel and managers of Interest free

banking in Ethiopia are recruits from conventional banks who are not really conversant with Interest free banking operations.

Thus, there is low understanding of moral and religious implications with the business venture; as a result IFB faces other risks in addition to the regular risk encountered by the CBs.

Only 54 (42.9%) of respondents agreed on IFB has expertise and institutional capacity for Research and Development (R & D) in Ethiopian banks, the rest disagree on the availability of expertise and institutional capacity for developing R& D center.

And they argue that even if there is a need for banking professionals to be properly trained on Interest free banking and finance. But most of the banks' professionals and experts have been trained in conventional economics; they lack the requisite vision and conviction about the efficiency of the Islamic banking. This result is same to the finding by Mohamed M. Olad studied 2012 Prospects, Opportunities and Challenges in Ethiopia.

91 (72.2%) of respondents agreed that without an efficient Sharia'a experts and human power operating within the sector may not continue to grow IFB meaningfully. As per the respondents an efficient Sharia'a experts and human power is not only necessary for the realization of their full potential, but also for the survival of the sector in this age of fierce competition, sophisticated markets and an informed public is absent, it is necessary to have well trained man power.

83(65.9%) of the respondents agreed on IFB are hunted by the chronic problem of expertise to the sharia compliant service, since any new financial product cannot be adopted without being approved by the Shari'ah advisory board.

71(56.4%) of the respondent disagree on the IFB has challenges in developing innovative services and products due to well-trained employee and expertise, as per the respondents there are no training centers on Interest free banking sector in the Country and no refresher courses for professionals to improve their skills.

Lack of qualified manpower is one of the biggest hurdles in the advancement of Interest free banking. Pioneers in Interest free banking developed their financial instruments and carefully trained their staff. There is no training institute to meet manpower needs of existing and future Islamic banks in Ethiopian case. Some of the reasons for this hurdle are understandable of IFB product and services. For example, lack of consensus on form and details of Islamic financial instruments and nonexistence of Islamic reporting and accounting procedures. Some work has been done. But a lot more is still needed, especially on the fundamentals. However, there is enough published or website material to offer short training courses in Interest free banking.

In Ethiopia Interest free banking operation supported by professional bankers from conventional banks. But they were not well-versed in the Shari’ah. Therefore, Interest free banking model emerged as “banking under Shari’ah supervision”. Practically this was done by Oromia International Bank through delegating authority for the Shari’ah matters to the respective Shari’ah Boards, absolving Islamic bankers of their responsibility in Shari’ah violations. Of course, in principle, Shari’ah Boards have the authority to impose their viewpoint. But this consideration does not monitored by other IFB bank.

4.3.4 Misunderstanding and Lack of Standardization of Islamic Financial Concept

Table4.6. Frequency result for Misunderstanding and Lack of Standardization.

N	Misunderstanding and Lack of Standardization of Islamic Financial Concept	strongly disagree		Disagree		Neutral		Agree		strongly agree	
		(N)	(%)	(N)	(%)	(N)	(%)	(N)	(%)	(N)	(%)
1	I have a clearly idea on how IFB product works.	4	3.2	6	4.8	16	12.7	49	38.9	51	40.5
2	I understand the reason why interest is prohibited in Islamic banking and what are its effects	10	7.9	4	3.2	0	0	49	38.9	63	50

	on society and economy.										
3	I think that Ethiopia is still lack of knowledge on IFB and financial institution.	10	7.9	4	3.2	12	9.5	19	15.1	81	64.3
4	Public educations and campaigns are still not effective to spread the awareness of Islamic financial industries to Ethiopia.	16	12.7	4	3.2	2	1.6	27	21.4	77	61.1
5	Ethiopia is facing difficulties in develop IFB because the awareness of Islamic financial industries by public is still weak.	10	7.9	0	0	8	6.3	31	24.6	77	61.1

Most of the respondents (88.9%) understand the reason why interest rate is prohibited in Islamic banking and they know the harmful impacts of interest rate to the society and economy.

79.4% of the respondents on this research truly understand how Islamic banking product (saving and financing) works.

However, there are only 20 respondents (15.9%) disagree that “the public educations and campaigns are still not effective to spread the awareness of Islamic financial industries to Ethiopia.” They think that the development of Interest free banking in Ethiopia facing challenges is not because of the ineffective of public educations and campaigns rather they believe that enough customers are approaching but the capability of the banks to provide the service are in question due to so many reasons.

There is no question about Islamic financial model feasibility. In fact, with the availability of more financing modes than those recognized at present in Ethiopia, it is bound to be more versatile and efficient. But it faces problem of general acceptability. This is mainly due to unfamiliarity with the various Islamic modes of financing. This problem is likely to be solved over time. But pace of development of Interest free banking can be expedited through the fol-

lowing: (1) public education campaigns, (2) inclusion of Interest free banking concepts in R & D centre, (3) making Islamic financing course a part of business administration programs and (4) Implement full-fledged interest free banking model.

This finding is actually consistent with what Islamic Banking literature has revealed about the operational challenges of Islamic Banking elsewhere.

4.4 Opportunities of Interest free banking in Ethiopia

Table 4.7 Frequency result for Opportunities of Interest free banking in Ethiopia

N	Opportunities of Interest Free Banking in Ethiopia.	strongly disagree		Disagree		Neutral		Agree		strongly agree	
		(N)	(%)	(N)	(%)	(N)	(%)	(N)	(%)	(N)	(%)
1	IFB is a flexible financial system and easy to adopt.	16	12.7	18	14.3	22	17.5	43	34.1	27	21.4
2	IFB has strong set up to product development.	4	3.2	6	4.8	40	31.7	47	37.3	29	23
3	Islamic bank has a good system to maintain the risk well.	4	3.2	6	4.8	34	27	43	34.1	39	31
4	The bank has in place a regular reporting system regarding risk management for senior officers and management.	4	3.2	22	17.5	39	31	55	43.7	6	4.8
5	IFB system is helpful for growth of Ethiopian economy.	10	7.9	4	3.2	0	0	55	43.7	57	45.2

There are 82 respondents (60.3%) admit that the Interest free banking has strong set up to product development and 122 respondents (88.9%) agreed that the IFB system is helpful for growth of Ethiopian economy. Above the data showed that the IFB in Ethiopia has evolved as

a viable and competitive component on the overall financial system as a driver of economic growth and development.

An interest free banking system with well developing and a tremendous economic growth at the same time pull our attention to examine whether or not the Islamic banking system that currently applied in Ethiopia really contribute in the long-run to economic growth of Ethiopia. In opposite of that, there are 34 respondents (27%) disagreed “IFB is a flexible financial system and easy to adopt,” the respondents feel that the Islamic banking may very hard to adopt and it’s a fixed financial system based on the Shariah rules.

The above finding about the opportunities is actually consistent with what Islamic Banking literature has revealed about the opportunities of Islamic Banking elsewhere. And a study by Ahmed (2008) investigates the opportunities and challenges of development and growth of Islamic banking in the UK. The study used the interviews with three different groups of people such as the Banking Authorities, the Customers of Islamic banking and non-Customers of Islamic banking. The results of the study indicate that there are enormous opportunities in the UK for development and growth of Islamic financial system. Also, the study concluded that there is need to educate the Muslim and non-Muslim community toward Islamic financial products and service to enhance its growth and profitability which is the same in Ethiopian case as per the above result.

As per the researchers finding and figures shown about Oromia International Bank (OIB) financial performance for 2016/2017 financial year 168 million profit recorded and deposit of 2.5 billion achieved and also Commercial Bank Of Ethiopia (CBE) achieved deposit of 8.5 billion. So the opportunity of IFB in Ethiopian banking sectors continue to be relevant in the foreseeable future prospect even if it working in the prevalent interest-based framework.

Nature of Islamic financial instruments implies that IFB face not only the traditional commercial credit risk of their clients but also other risks associated with the instruments. For example, market risk for salam financing or potentially damaging claims due to ownership of assets in lease financing. Several such risks can be addressed through design of financial con-

tracts. As for commercial credit risk of the client, Islamic banks can reduce it through the following action:

- Innovative collateral arrangements, third-party guarantees and credit rating of clients by specialized institutions
- Choice of an appropriate financial instrument available in the Islamic setup
- Pricing of Islamic financial products.

Islamic banks are likely to have advantage in risk management as compared with their interest-based counterparts who can make recourse to only the first and the third option.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

The main objective of this study was to identify the main operational challenges of interest free banking and its opportunities in the case of five selected commercial banks in Ethiopia that have been operate over the period of 2013- 2018.

In light of this objective, the study adopted explanatory research approach to answer the research questions. Consequently, the study used a total of 126 respondents.

- As per the questionnaires' filled by the respondents "Misunderstanding and Lack of Standardization of IFB Concept" is the major and first operational challenge of IFB in Ethiopia (83.72%) from the four independent variables that is currently faced by the banks. The unfamiliarity towards the Shariah principle and different methodologies makes the concept of Interest free banking become unclear and most of the people are relating the sector as part of religion.

- The second among the remaining three challenges as per the independent variables larger number of respondents has agreed with this statement - "Proper Legal and Regulatory frame work" are the operational challenges of IFB (77.44%). It means that this is the most critical operational challenge that facing by Ethiopian banks right now. One reason it constrained the bank to limit its IFB service especially its financing and products and in addition due to the inexistence of relevant legislation, each bank has adopted their own methodology, models and benchmarks for launching IFB products with little coherence or commonality in the market. This is because of all rule and regulations set to IFB in Ethiopia is the one already set to the conventional bank.

- “Lack of *Sharia'a* experts and *Man power*” contributed by 60.5% of respondents. As per the respondents IFB depends on adequately qualified human personnel, well trained man power, and training centre(R &D) on Islamic finance not exist in the Country and no refresher courses for professionals to improve their skills are provided.
- The least respondents 56.16% supported the challenge that “Limited Market-Based Financial Intermediations and Products” is operational challenge of IFB. As per the respondents IFB expose to liquidity problem due to the lack of developed money market and the shortage of short term investment securities such as treasury bills and marketable securities which offer limited market with optimum returns. Unlike conventional banks, IFB are prohibited to issue treasury securities to maintain liquidity. There are still no other related alternatives to substitute treasury securities to carry out the liquidity function.

5.2 Recommendations

Based on the findings of the study, the following recommendations are forwarded:

Interest-Free Banking in Ethiopia has so many operational challenges mainly due to misunderstanding and Lack of Standardization of IFB Concept, lack of proper legal and regulatory framework along with a shortage of local qualified Islamic sharias experts and man powers and very slightly the limited market. In order to IFB gain its opportunities in Ethiopia, each of these challenges needs to be addressed adequately.

- Supervision of Islamic banks is equally important. At present, lack of effective prudential regulation is one of the weaknesses of the Islamic institutions. Hence, Shariah Supervisory Board has to making an effective supervision framework to manage all the financial institutions in Ethiopia.
- As banking regulator, the National Bank of Ethiopia (NBE), should take an open approach and show unmistakably that they had no objection in principle to the idea of Islamic banking by recognizing its growing importance in Ethiopia and its emergence

on the international stage as well as the need to put Islamic banking in the context of social equity and fairness. And also NBE should adopt IFSB that provides prudential standards and guidelines for regulatory and supervisory agencies to ensure soundness and stability of Islamic Financial industry including: retail banking, capital markets and Takaful (Islamic insurance).

- Sheria'a experts and Employees of IFB should have the knowledge and also should have the business concept in addition to the Islamic rule. Public educations and campaigns of IFB concept are still not effective to spread the awareness of interest free banking concept, as a result the researcher recommend National Bank of Ethiopia and the Shariah Supervisory Board in Ethiopia has to provide more training and create awareness to the staff and public in order to get more opportunities and minimize the operational challenges by providing R & D centre and training centre.

- NBE should give more emphasis for challenges the banks faces on the operation. Islamic Financial Intermediations and products specializing in Shariah-compliant products have been functioning based on the same business model and without much innovation in their mode of operations. Hence, financial intermediaries have to specialize in mobilizing deposits, identifying investment opportunities, structuring, packing securities and originating, while allowing the complementary financial to fill the remaining gaps and provide liquidity and market sharing.

In view of the above, it will be more fruitful if the following approach is adopted:

- The Islamic financial instruments should be properly and fully developed, accommodating all relevant factors.
- (2) Principle of Interest free banking should set economic and Shari'ah parameters for providing bank financing.
- (3) Bank officials at the branch level should be given full freedom for making routine financing decisions, of course, in the light of the abovementioned parameters.

- (4) There should be both random and regular, either biannual or annual, Shari'ah audit of all financing operations.
- (5) The prospects of Shari'ah compliance should be enhanced through introduction of penalties for the bank staff and Shari'ah-rating of the bank. The above approach shall be needed in any case for expediting Interest free banking operation.

5.3 Research limitations and future research directions

While this study focused on operational challenges of interest free banking and its opportunities future research could be carried out on same issue by adding new independent variables which can be substituted or add on to the existing independent variables and also the research will not solely depend on distribution of questionnaires rather it can entertain interview.

In the future research, the recommendation and the limitation of this research will be addressed and overcome. Furthermore, through applying different research model can enhance the accuracy of the result. The research model can be expanded so that it can fully reflect the operational challenges facing Interest free banking in Ethiopia.

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Appendix A

Glossary of Interest Free Banking

Allah: The Creator, an Administrative of the Universe; God

Amanah: Trust, with associated meanings of responsibility, truthfulness and sincerity.

Arbun: Down payment; a non-refundable deposit paid by the buyer to the seller upon finishing a contract of sale, with the condition that the contract will be completed during the prearranged period.

Bai-mua'jjal (deferred payment sale) is a deferred payment sale contract which is traded without additional costs.

Gharar: (Uncertainty) is a sophisticated concept that covers certain types of insecurity or contingency in an agreement.

Halal: Any activity or transaction that is according to law and also permitted in Islam is known as halal.

Haram: Any business or contract that is unlawful and also prohibited in Islam is known as haram.

Islamic banking: Financial services that meet the requirements of the Sha'riah (Islamic law)

Ijara: Ijara is a kind of lease; it allows the bank to earn profits by charging rentals on the assets leased to the customer. Ijara wa Iqtinah extends the concept to a hire purchase agreement.

Maysir: (Gambling) one of three fundamental prohibitions in Islamic finance.

Mudaraba: is an investment partnership, whereby the investor (the Rub ul Mal) provides capital to another party (the Mudarib) in order to undertake an investment activity.

Mudarib: The mudarib is the entrepreneur or investment manager in a mudarabah who invests the investors funds in a project or portfolio in exchange for a share of the profits.

Murabaha: Purchase and resale. Instead of lending out money, the capital provider purchases the desired commodity from a third party and resells it at a prearranged higher price to the capital user.

Musharaka: profit and loss sharing. It is a partnership where profits are shared as per an agreed ratio whereas the losses are shared in proportion to the investment of each partner.

Prophet: Hazrat Muhammad Mustafa (PBUH)

Quran: The Holy book of Muslims revealed on Hazrat Muhammad Mustafa (PBUH)

Qard: A Qard is a loan, free of interest. Banks use this arrangement for current accounts holders. In essence, it means that a Current Account is a loan to the bank, which is used by the bank for investment and other purposes.

Riba: Interest, Usury. The legal concept extends beyond just interest but in simple terms, riba covers any return of money on money—whether the interest is fixed or floating, simple or compounded, and at whatever the rate. Riba is strictly prohibited in Islam.

Sha'riah: Islamic law as revealed in the Quran and through the example of Prophet Muhammad (PBUH). A Sha'riah compliant product meets the requirements of Islamic law.

Sha'riah advisor: An independent professional, usually a classically trained Islamic legal scholar that advises an Islamic bank on the compliance of its products and services with the sha'riah, or Islamic law.

Sha'riah Compliant: An act or activity that complies with the requirements of sha'riah or Islamic law.

Sukuk: Sukuk is the Arabic name for a financial certificate but can be seen as an Islamic equivalent of a bond.

Sunnah: way of life of Prophet Hazrat Muhammad Mustafa (PBUH); They said about anything, they act anything is called as Sunnah.

Surah: Chapters of Quran; there are 540 Sura in Quran.

Takaful: Islamic insurance.

Tawarruq: Reverse Murabaha. As used in personal financing, a customer with an actual need buys something on credit from bank on a deferred payment basis and then instantly resells it for cash to a third party. In this way, the customer can take cash without taking an interest-based loan.

Wakala: Wakala is an agency contract which generally includes in its terms a fee for the skill of the agent.

Zakat: Zakat is one of the five pillars of Islam. It is obligatory for Muslims to pay their wealth to specified categories in society when their annual wealth exceeds a minimum level.

QUESTIONNAIRE
ADDIS ABABA UNIVERSITY
FACULTY OF BUSINESS AND ECONOMICS- DEPARTMENT OF AC-
COUNTING AND FINANCE

Researcher: Wondwossen Teshome

Contact Address: +251-911-14-96-86

Email: aawonde@gmail.com

Dear Respondent,

I am pursuing MSCs in Accounting and Finance at Addis Ababa University, Ethiopia. And I am doing a dissertation on the operational challenges and opportunities of interest free banking: A descriptive research method. I very humbly request you to spend your five to ten minutes of precious time in filling the questionnaire as per your perception about the operational challenges of interest free banking and its opportunities. Your contribution in this regard will be highly appreciated and will be acknowledged at the time of submission of the dissertation.

Thank you in advance for your cooperation!

Instructions:-

- writing your name is unnecessary.
- Put “ ”mark as per the questions required in the circle or answer in the space provided.

Part One: Respond the following general question

1. please select your age

Under 25 25-35 36-45 above 45

2. What is your gender

Female Male

3. Education qualification

Diploma Bachelor degree Masters

4. Professional level

Senior level Head level Manager Level

5. Choose one that best suits you:

I am a Muslim I am a Non-Muslim

6. Natures of training you get on Interest free banking.

Certificate Conference on Islamic Banking /Finance

Workshop for Islamic Banking /Training

7. Do you have experience of working in interest free Banking?

Yes No

Part Two: Respondents opinion on concerning the information of IFBs operational challenges.

Next, there are listed of items which deal with respondents view on operational challenges facing IFB industries. These items will explore respondents’ assessment of Operational challenges facing IFB. So Please tick(□)the number that you feel most appropriate, using the scale from 1 to 5 (Where 1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree and 5 = Strongly Agree)

Scale: Strongly agree (5) Agree (4) Neutral (3) Disagree (2) Strongly Disagree (1)

No	Proper Legal and Regulatory frame work	1	2	3	4	5
1	IFB do not invest in industries with products and services involved (Alcohol, Pork and Gambling).					
2	IFB is lack of effective supervisory framework					
3	Lack of effective prudential regulation is one of the weaknesses of the IFB industry in Ethiopia.					
4	IFB has devised their own practices and procedures to accomplish their banking activities.					
5	The role of Shariah boards brings unique operational challenges to the governance of IFB.					

Scale: Strongly agree (5) Agree (4) Neutral (3) Disagree (2) strongly Disagree (1)

No	Limited Market- Based Financial Intermediations and Products	1	2	3	4	5
1	There are no much choices on IFB products compare to Conventional banks.					
2	IFB exposes themselves to liquidity problem due to the lack of developed money market and the shortage of short term investment securities.					
3	There is incompleteness of traditional financial instruments in Islamic banking.					
4	The major difficulty to develop Interest free banking is because of the limited financial instruments.					
5	Creation of a larger size of local Islamic liquidity market become challenging due to the smaller economies of scale compared to conventional banking industry.					

Scale: Strongly agree (5) Agree (4) Neutral (3) Disagree (2) Strongly Disagree (1)

No	<i>Sharia'a Experts and Man power</i>	1	2	3	4	5
1	IFB has enough man power who are cable in adaptability to technology					
2	IFB has expertise and institutional capacity for Research and Development (R & D) in Ethiopian banks					
3	Without an efficient human power operating within the sector may not continue to grow IFB meaningfully.					
4	IFB are hunted by the chronic problem of <i>Sharia'a</i> experts to the sharia compliant service.					
5	IFB has challenges in developing innovative services and products due to well trained employee and expertise.					

Scale: Strongly agree (5) Agree (4) Neutral (3) Disagree (2) Strongly Disagree (1)

No	Misunderstanding and Lack of Standardization of Islamic Financial Concept	1	2	3	4	5
1	I have a clearly idea on how Islamic banking product works.					
2	I understand the reason why interest is prohibited in Islamic banking and what are its effects on society and economy.					
3	I think that Ethiopia is still lack of knowledge on Interest Free banking and financial institution.					
4	Public educations and campaigns are still not effective to spread the awareness of Islamic financial industries to Ethiopia.					
5	Ethiopia is facing difficulties in develop Interest Free banking because the awareness of Islamic financial industries by public is still weak.					

Opportunities of Interest Free Banking in Ethiopia.

Scale: Strongly agree (5) Agree (4) Neutral (3) Disagree (2) strongly Disagree (1)

No	Opportunities of Interest Free Banking in Ethiopia.	1	2	3	4	5
1	Islamic banking is a flexible financial system and easy to adopt.					
2	Islamic banking has strong set up to product development.					
3	Islamic bank has a good system to maintain the risk well.					
4	The bank has in place a regular reporting system regarding risk management for senior officers and management.					
5	Islamic banking system is helpful for growth of Ethiopian economy.					

Scale: YES (1) NO (2)

No	Dependent Variable	1	2
1	Interest free banking has operational challenges in Ethiopian banking industries.		

1. If you have any other opinion regarding to Islamic banking operational challenges and its opportunities.

Thank You for Your Time