



Addis Ababa University
College of Business and Economics
Department of Business Administration

**Practices and Challenges of Interest Free Banking
Windows of Commercial Banks in Ethiopia**

BY:

Jemal Nassir

June, 2018

Addis Ababa

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A research project paper submitted to Addis Ababa University Department of
Business Administration in partial fulfillment of the requirements for the Degree of
Masters of Business Administration in Finance

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Acknowledgments

First and foremost, I am very grateful to Allah, the Almighty, for giving me the strength, and energy to undergo all the challenges in life. Also, I am grateful to Allah who enables me to complete this work.

Secondly, in the course of this research, I am extremely grateful to my advisor, Dr. Alem Hagos (PhD), for his professional advice, guidance, suggestions, encouragement, patience and invaluable assistance during the entire process as well for being very kind, warm-hearted and polite to me throughout my work.

Next, I would like to express my gratitude to my mother, my fathers, my brothers, sisters, friends for their support and encouragement during my journey towards the completion of this study, and without whose constant encouragement, understanding and support the work would not have been completed.

Finally I am also grateful to the all commercial Bank offering IFB services for their co-operation.

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List of Acronyms/Abbreviations

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AB	Abay Bank
AbB	Abyssinia Bank
AIB	Awash International Bank
CAGR	Cumulative Annual Growth Rate
CBE	Commercial bank of Ethiopia
CBO	Cooperative Bank of Oromia
DB	Dashen Bank
FCY	Foreign currency
IAIB	International Association of Islamic Bank
IBF	Islamic Banking and Finance
IFB	Interest Free Banking
NBE	National Bank of Ethiopia
NIB	Nib International Bank
OIC	Organization of Islamic Conference
OIB	Oromia international bank
PLS	Profit and loss sharing
SDD	Special demand deposit
SSB	Shari'ah Supervisory Board
SPSS	Statistical Package for Social Sciences
UB	United Bank
WB	Wegagen Bank

Abstract

This research work attempts to provide empirical evidence on Practices and challenges of interest free banking in Ethiopia with particular reference to Commercial banks currently offering interest free banking service. The study has employed descriptive research based on survey and the data are of cross sectional type. The study has used structured and semi structured questionnaire and interview. A total of 560 sample respondents were taken through multistage sampling. Of the total sample interest free banking customers and staffs of the bank constitutes 384 and 176 respectively. The data was analyzed using descriptive statistics of mean, frequency and percentage using SPSS version 20 Software. The findings showed that Interest free banking services have been benefiting banks, not only in terms of increasing customers and mobilizing deposits, but also they enjoyed greater profitability and FCY generation. The findings also show that currently knowledge of bankers and customers on Interest free banking and IFB products is low. Moreover a of customers' sampled show they are skeptic about Interest free banking window of commercial banks' ability manage their fund and Shari'ah compliance these windows. Furthermore, the compliance of theses windows merely depends on maintaining separate records and accounts which lacks shariah advisor and management commitment to ensure fully compliance with requirements for adopting interest free banking within the bank. In addition the result indicates lack of supervision by NBE, lack of confidence and trust of clients, lack of legal support from government, lack of qualified human resource, lack of cooperation among Islamic windows, lack of infrastructure suitable for Interest free banking operation, and doubt of clients identified by the practitioners as major challenges in the process of offering interest free banking services in Ethiopia. Accordingly, the study recommends that there should be vigorous public enlightenment programmes to create more awareness and to remove misconception and doubt among Muslim and non-Muslim; Shareholders, board of directors and the management of the bank should accept the concept and be cooperative with interest free banking window of the banking and establish a working Shari'ah supervisory board (SSB) for interest free banking operation and strictly comply with its guidance; The government of Ethiopia should take more proactive efforts to promote Interest free banking services with certain amendments laws and regulations and NBE should also establish a separate department for handling all issues relating to Interest-Free Banking and closely monitor and supervise the operation of interest banking windows of conventional banks.

Key words: *Interest free banking, Interest free banking window, Shariah compliance, challenges*

CHAPTER ONE

1.1 Background of the Study

Banking is an unavoidable entity in the modern economic system. It is one of the essential mediums for mobilizing development funds and sustainable economic activities. The most recent and significant development in the banking industry is the emergence of Islamic Banking System and Interest-Free Banks (hereinafter IFBs) in both developing and developed countries of the world (Ibrahim, Malami, and Abdullahi, 2011). During the past five decades Interest free banks have evolved from mere wish and concepts into fully fledged realities and proved increasingly attractive, not only to Muslims but also to many others who are beginning to understand the unique aspects of Islamic finance (Timewell & DiVanna (2008) cited in Islam & Kozokov, 2009). This is in response to the failure of the conventional interest-based banking system to cater for the developmental needs of most countries, particularly the developing economies (Ahmed, 2000). In addition to this, there are also many contributory factors for such growth Bellalah & Masood (2013) stated that “the liberalisation of financial regulation; the globalisation of financial markets; changes in technology; product innovation; the birth of several new Islamic states; and the growing Islamic presence in the West” are most notable factors for the growth of Islamic Banking. The successful operation of IFBs in several parts of the world has led to a growing interest in Interest free financing techniques and also raised a number of questions. Do Interest free banks really have something new to offer? Are the functions, activities and banking techniques of Interest free banks any different from those of conventional commercial banks? If yes, in what respect do they differ? What are the similarities or dissimilarities with respect to these activities among Interest free banks themselves? These and similar other questions are generally raised whenever the subject of Interest free banking is mentioned (IFSB, 2011).

Developing a more inclusive financial system in any given country is a primary determinant of the soundness of a financial system and its stability and public trust and confidence in its institutions and markets. This could best be achieved through the financial inclusion of the major segment of the economically active segment of the society. Interest-Free banking as an alternative financial service and product will play a great role in bringing a large segment of the hitherto unbanked and under-banked segments of the society into the mainstream organized and

formal financial system. It has been about half a century now since Sharia-based banking products emerged globally. Trends in the global market show that acceptance of IFB is not limited to Muslim majority countries. It is also being expanding in those parts of the globe where the population is mostly non-Muslim.

Interest-Free Banking has the same purpose as conventional banking except it is based on a comprehensive system of ethics and moral values stemming from the religion of Islam. International Association of Islamic Banks (as cited in Ramlan & Adnan, 2016) defined the Islamic banking as “the Islamic Bank basically implements a new banking concept in that it adheres strictly to the rules of Islamic Shariah in the fields of finance and other dealings”. Therefore, the point is obviously clear that Islamic banking differentiates from conventional banking in terms and conditions of its mission and objectives and duties toward society. The Interest-Free Banks takes all these duties and responsibilities greater than conventional banks (Hassan & Adnan, 1998). Whereas, conventional banking is fundamentally based on the debtor-creditor relationship between the depositors and the bank on the one hand and between the borrowers and the bank on the other, with interest as the price of credit, that reflect the opportunity cost of money (Ramlan & Adnan 2016). Without a clear understanding of these differences, some people, even experts tend to make a common mistake of equating Islamic banks with other conventional banks with the mere change of name (Siddiqui, 2013).

The concept of Islamic Banking and Interest-Free Banking are synonymously used in Islamic economics literature as an alternative banking framework to the interest-based conventional banking practice. Although in technical terms, there is a difference between an interest-free bank and an Islamic bank they are sometimes used interchangeably (Ibrahim et al., 2011). Interest free banking is a narrow concept denoting the number of banking instruments or operations, which avoid interest. Islamic banking, the more general term is expected not only to avoid interest-based transactions, prohibited in the Islamic Shariah, but also to avoid unethical practices and participate actively in achieving the goals and objectives of an Islamic economy.

The industry is now becoming a global phenomenon since more and more countries want to implement interest free banking in their jurisdictions (Sole, 2007). Interestingly, IFB has been developed using two different models. The first model consists in setting up fully fledged IFBs

while the second model consists in setting up Subsidiary and windows dedicated to Islamic finance within conventional banks (Faye, Triki & Kangoye, 2013).IFB windows are simply defined as special facilities offered by conventional banks to provide IFB services to customers who wish to deal with IFB. On the other hand, IFB subsidiary is defined as IFB products and services offered by subsidiaries of conventional banks, but the operation and management of the two are clearly separated (Sole, 2007). In some countries, fully fledged Interest-Free Banking is the only model practiced in the entire economy. These include Iran, Pakistan, and Sudan. In others, the model coexists with the conventional system of banking thereby creating a dual banking system (Chong and Liu, 2009). In Ethiopia, IFB introduces in the latter case conventional commercial banks offer IFB service through a dedicated window under the same rough along with conventional banking services. In other words, the existing legislation in the country does not allow the setting up of full-fledged Islamic banks. Moreover, Interest-Free Banking is steadily moving into the conventional financial system (Sole, 2007). The growth and popularity of Islamic banking have been facilitated by the conventional banks that employed their resources, brand, scale, technology, and expertise to capture, retain and grow their market shares. Most of these conventional banks established Islamic banking windows or a separate Subsidiary branch to offer Sharia-compliant products and solutions in response to the rising demand for such Sharia-compliant banking products and services. In addition to this, another strong example is that seven out of top ten conventional banks with an international presence have commenced Islamic banking. Big global banks such as Citibank, Deutsche Bank , HSBC, and Standard Chartered setting up Islamic window operations or even Islamic banking subsidiaries.

Ethiopia is the second most populous country in the Africa about 33.9 percent are Muslims (www.theodora.com/wfb current accessed 24/2/2018). However, until recently, there were no financial institutions catering to the large population requiring sharia-compliant products; even though, efforts for the establishment of Interest Free Bank in Ethiopia was made by ZemZem bank, a full-fledged interest-free bank, but was unable to start operations as the directive requires that interest-free banking be given alongside conventional banking services. The idea of creating an infrastructure to support interest-free banking in Ethiopia has gained more support in recent years though proclamation by the National Bank of Ethiopia (NBE), and then in 2011, issued formal directives on Sharia-compliant finance (The Guardian, 2015). However, the directive has

only opened the door for existing commercial banks to create an interest-free banking window alongside their operations. Interest-free banking in Ethiopia started in September 2013, when the Oromia Bank S.C launched the service followed by Commercial Bank of Ethiopia and United bank S.C on October 2013 and May 2014 respectively. Currently, there are seven interest free banking windows of Commercial banks, operating with more than 1000 branches in different parts of the country as on Oct 1, 2017. During the year, additions of 3 new Interest free banking windows are expected to start their operations.

It has now been about five years since Ethiopian banks are allowed to provide interest free banking services through dedicating windows in their conventional branches. The number of institutions offering Sharia-compliant services has risen as has the number of Commercial banks that have opened Islamic windows. The service is getting encouraging public acceptance within this short period of time, and the total volume of deposits that all these banks manage has risen rapidly. However, these developments, no doubt raised a number of critical issues, posed a number challenges to practitioners, regulators as well as clients. Whereas, the information on the interest free banking practices and findings on different practices and challenges of interest free banking is scant or tin. So that, it is important to understand the status, challenges and issues of Interest free banking activities of conventional banks. Capturing detailed information on these points would help practitioners to handle challenges for achieving a continued expansion of the Interest free banking service with in Commercial banks. Hence, in this study, an attempt made to empirically investigate challenges of interest free banking windows of Commercial banks in Ethiopia.

1.2 STATEMENT OF THE PROBLEM

The Banking industry in Ethiopia has been operating in the country for over a century but interest-free banking had never been practiced even though around one third of Ethiopians identify as Muslim. They had been precluded themselves from dealing with commercial banking activities considering its dependability on interest. Recently, many commercial banks have started using Interest free banking transactions, tools and techniques in their banking operations. This is really encouraging and motivating for the banking industry as a whole, particularly interest free banking since significant amounts of adult population does not have access to formal

banking because of either unavailability of formal banking framework or paying or receiving interest prohibited in the religious or other social ethos.

However, formation and operationalization/implementation of interest free banking with in conventional banks has raised and created eminent challenges' (Sobhani, Murtaz and Omar, 2016). They are facing some criticism with a sense of suspicion among the Islamic scholars and the Islamic banking clients on the authenticity, clearance of monitory system, etc. (Ibid). Some scholars argue that conventional banks should not be permissible to open Islamic windows, as their sources for fund is unlawful. Hence they are not complying with Sharia at first place exploiting the Muslim investors and unfairly competing with Islamic financial institutions. On the other hand, there is a group of contemporary scholars who permit this type of banking service as long as the sharia conditions laid down for them are satisfied and fulfill certain required conditions such as: complete segregation of funds; the existence of a Sharia supervisory board; management committed to Islamic financial concepts; safeguarding Muslim investors' funds from negligence, trespass, and fraud; and compliance with the standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) (Yaquby,2000). Generally, Sharia scholars have approved Interest free banking windows subject to the bank complying with guidelines set by the Sharia scholars. However, many Islamic banking clients also believe that conventional banks are involved in immoral activities from an Islamic Sharia point of view. Hence, there is still a sense of suspicion and mistrust amongst the majority of interest free banking clients with regards to these “Islamic windows” and their Interest free banking products. This explains the reluctance from numerous Interest free banking clients to deal with Islamic windows and their financial products (Al- Awsat, 2010).

According to experts, the formation of Interest free banking under the bank is like forming a new bank, because the service provided is quite separate from the conventional banking system. It is not like launching one service under the bank. It means forming an additional independent financial institution under the bank; therefore, it needs more preparation and a different and separate office that operates the interest-free banking (www.addisfortune.net/article accessed 27/12/2017). So that, conventional banks established separate divisions within, namely Islamic Banking unit under which Islamic windows were opened. These divisions are independent and appointed religious bodies (Sharia Supervisory Committees) supervise their operations and

authorise and inspect their financial products. They also have their own principles, tools and techniques of operation. Therefore, the funds of Interest free banking windows are kept separate from those funds, which have not been mobilised by following Sharia provisions. The funds mobilised through Interest free banking windows are not commingled with the funds of the deposits mobilised through conventional branches. This is done through maintaining separate accounts, books, and records and this compliance is disclosed to the customers through annual reports, websites and other promotional materials. Conforming to these standards will help Interest free banking windows avoid confusion, misunderstanding and ambiguity and ensure clarity and sound Interest free banking practices. Despite these apparent difficulties, the number of commercial banks adopting at least some aspects of Interest free banking in their operations has continued to grow. The importance of the above issue cannot be overstated.

A significant amount of theoretical and empirical research on Islamic banks has been undertaken throughout the world. It is the conclusion of many studies that the establishment of Islamic banking in any country be it Muslim or non-Muslim faces a number of challenges, but they are not without remedies (Abubakar, & Bello, 2014). Bello and Abubakar (2014) categorized these obstacles into institutional and operational obstacles. The institutional obstacles include: inappropriate institution framework, inadequate legal framework, lack of equity institution, poor supervisory framework, and disparity in accounting standard, lack of short-term financial instruments and institutions and absence of secondary financial market. They identified the operational challenges to include religious, and cultural differences, inadequacy of financial innovations, lack of profit sharing finance, sharia related issues, inadequate human resources, inadequate awareness and competition. Even though Interest free banking faces these and some other challenges, some of them are very vital for its existence, such as Sharia compliance in its operations, knowledge and perception of financial industry practitioners about Interest Free banking and IFB products and services, the knowledge and perception of clients of Islamic window of conventional banks whether existing practice of Islamic window is Sharia compliant or mere copy of conventional practices under the banner of Sharia. The challenges is compounded by the fact that the environment in Ethiopia differs from that of other countries in that Ethiopia does not have ample experienced in dealing with IFB. In other words, the IFB is a new event in Ethiopia as evidenced by only commercial banks offering interest free banking products and services along with Interest based products in the past five years. Therefore, the

practices and operations of IFB is a process complication with obstacles and challenges that are distinct from other countries that have been pioneers in applying Interest free banking system for the past five decades.

In the context of Ethiopia, Information concerning interest free banking in general and the practices and challenges of interest free banking in particular has been made available through limited research activities only in recent years. An Example was a study conducted by Mohamed (2012) showed that lack of awareness, regulatory and supervisory challenges, institutional challenges, lack of support and link institutions, gap in research and development in Islamic studies, lack of qualified human resource as well as wrongful association with specific religion and the global terrorism movements are the major challenges of for the establishment of full-fledge Islamic bank in Ethiopia. Another important study conducted by Debebe (2015) showed that perceived relative advantage, perceived compatibility, customers' level of awareness and subjective norm have a significant positive impact on the attitude towards interest free banking in commercial bank of Ethiopia. Since there is deficiency in literature, identifying existing and possible challenges beneficiary for the development of the service as an industry and lesson for banks currently offering the service and those banks intended to offer the service in the future.

This study provides the empirical analysis of the practices and challenges of interest free banking in Ethiopia, particular reference to interest free banking windows of the commercial banks, Unlike previous studies, which either focuses on the challenges and prospect of establishing full-fledged Islamic banking or challenges of customer using IFB or case study on the challenges of IFB particular conventional bank. This study attempts to investigate the practices and challenges of Interest free banking windows managed by commercial banks in Ethiopia and to evaluate them critically.

1.3 Research Questions

The overarching research question that guides the study are what are challenges confront interest-free banking of conventional banks of Ethiopia? : From the central question, a number of sub-questions, in relation to the research problem and objectives of the study stated below, explored. The following are the research's sub-questions:

- What are the benefits of adopting Interest free banking services for conventional banks?
- What is the level of awareness and knowledge of the bankers' about the various IFB products and services and methods of finance?
- What is the level of awareness, knowledge and attitude of the customers of IFB about the various IFB products and services and methods of finance?
- What are the challenges in proper functioning of Interest free banking service of conventional banks Ethiopia?
- How far are the operations of these windows in strict compliance with Sharia requirements of Islamic windows of conventional banks?

1.4 Objectives of the study

1.4.1 General objective

The general objective of study is to describe practices and challenges of interest free banking in Ethiopia with particular reference to Commercial banks currently offering interest free banking service. Consequently, this study also provide a clear picture about challenges interest free banking within commercial banks in Ethiopia and suggest possible ways to improve Interest free banking of commercial banks'.

1.4.2 Specific objectives

More specifically this study has the following specific objectives:

- To examine the benefits of adopting interest free banking by commercial banks in Ethiopia;
- To evaluate the level of awareness of the bankers' about the various IFB products and services and methods of finance;
- To investigate the level of awareness, knowledge and attitude of the customers of IFB about the various IFB products and services and methods of finance;
- To examine the level of compliance with shariah requirements for conventional banks adopting interest free banking; and
- To identify the challenges facing commercial banks in proper functioning of Interest free banking service in Ethiopia.

1.5 Significance of the Study

This study has a practically and theoretically contribution. Theoretically, the study contribute to the existing pool of knowledge on interest free banking particularly in the Ethiopian context; serve as a basis for further research in the field of interest free banking. It also provides an understanding and explanation of the challenges facing interest free banking with in Commercial banks. Practically, Commercial banks Islamic windows may use the findings from this study to enhance their knowledge on practices and challenges of interest free windows. This study also can assist the bankers in formulating different strategies and policies to tackle challenges related with interest free banking. This study could also help both those banks currently have interest free window and intended to launch such product and service in the future.

1.6 Scope of the Study

This study could be comprehensive and all-inclusive in getting information and giving deep view of the status of interest free banking in Ethiopia if it addresses all banks in the country. However, in order to make the study more manageable in terms of the researcher's aim and interest, available time, finance and facilities, attempt was made to delimit the scope and dimension of the study with regards to:

- The topical scope –breadth and depth,
- Area to be covered,
- Informants to be studied, and
- Time to be covered

This study focused on IFB from the Ethiopian context. Given that the whole field of IFB is broad conceptually and in its applications and implications, it could be approached from several perspectives. However, this study narrows its scope to critical aspects of the IFB such as, the interest-free financial products and services of Commercial banks, challenges they faces currently and will face in future, and sharia compliance of Commercial banks Islamic window .

There are seventeen conventional commercial banks operating in Ethiopia banking industry. Ten out of seventeen licensing to offer Interest free banking products and services. The scope of the study comprised of seven conventional banks fully operating Interest free banking or Sharia-compliant banking, the rest are relatively new for Interest free banking and they were not fully operational when the research proposal had got approval. So that, the study is centered on the

IFB activities of Abay bank, Commercial bank of Ethiopia, Cooperative bank of Oromia, Nib International bank, Oromia international bank , United bank and Wegagen bank; and there IFB customers and staff there staff who have been operating interest free banking for quite a period of time. Furthermore, the study has been conducted in Addis Ababa city among branches of selected commercial banks Islamic windows for ease of reach and convenience to the researcher. With regard to the research participants that were included, the study aims to cover all informants, including Interest free account holders, managers branches of Commercial banks offering IFB services and the division head of Interest free banking service located in Addis Ababa districts. Lastly, In order to describe the current status of interest free banking the researcher has used the most recent five years data from the fiscal year 2013 GC up to 2017 GC.

1.7 Limitation of the study

The study limited mainly in Addis Ababa city and the study could not cover every aspect of banking with regards to the practice and challenges of the IFB model across the country, and respondents may not be reflective of the entire IFB clients in Ethiopia. The other limitation was, study was conducted on Commercial Banks which have Interest free banking windows and did launched the service at full scale (not at pilot stage), The finding of this study is limited to these Commercial banks interest free banking windows, must be made with caution. However, none of these affected the quality of the research.

1.8 Organization of the Paper

The research organized under five chapters.

- **Chapter I** deal with the problem and its approach which includes background of the study, statement of the problem, research objectives, scope of the study, and significance of the study and organization of the research.
- **Chapter II** provides a detail review of relevant literature to connect to the research questions. This chapter covered the theoretical and empirical reviews insight regarding the sector.
- **Chapter III** presents the methodological concerns that used in conducting this research and provides a justification for each step taken.
- **Chapter IV** presents the summarized results/findings of this study and interprets and/or discusses the findings to address the research questions and objectives.
- **Chapter V** presents the conclusion drawn from the findings, the recommendations made to address the problems stated in chapter one. All the reference materials used in the study are listed under bibliography.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

The review of relevant related literature forms a critical part of any research activity. It helps to establish the theoretical framework and foundation of the field of study. To this end, this chapter attempts to capture the related literature on various themes that underpin the topic under study. The related literature review begins by discussing Interest free banking system. These include the conceptual underlying of IFB, fundamental principles of interest free banking, operating models of interest free banking, and shariah requirements for conventional banks to operate interest free banking. A detailed description of various theoretical and practical issues related with Islamic banking or Interest free banking have been discussed with the intention that the reader has a basic and essential understanding of Interest free banking. Next, it explains challenges for the Interest free banking that were identified by previous researchers. The challenges described in this chapter are from various countries that are related to the subject of the study.

2.1. Theoretical Literature Review

2.1.1. Concept of Islamic Banking

Islamic banking is a universal concept which is in practice in banks in both Muslim majority and Muslim minority countries of the world. Unlike the conventional banking system, the Islamic banking system can be defined as a faith based system of banking, which derives its principles from the Islamic Sharia. This can be understood in the following definitions from different authors and organizations. For instance, the organization of Islamic Conference (OIC) defined Islamic banking as “a financial institution whose status, rules and procedures expressly state its commitment to the principle of sharia and to the banning of the receipt and payment of interest on any of its operations”. (Hassan, 1999 cited in Alamgir, Hossain and Faisal (2017, P, 5) That is, Islamic banking is built on a set of principles emanating from the Sharia. The European Central Bank (2011) sees Islamic bank as a banking system that complies with Islamic religious law (Sharia). Furthermore, Islamic Banking is defined as the conduct of banking operations in consonance with Islamic teachings (Haque, Jamil and Ahmad, 2007). In addition, Filippo, Pierluigi, Stéphane, Angela, Lauren, Baljeet, Sergio, Steven, and Sajjad, (2013) opined that the Islamic banking system has a distinctive feature that tries to reconcile a secular banking system

with the basic tenets of the Islamic faith. In tandem with the above definitions, Islamic banking classified as a religious innovation that provides an ethical investment (Edwardes, 2000) cited in Noman (2002).

However the term Islamic Bank may be defined in some different specific term according to the territorial anatomy of the country or region. Keeping in view the objective of Islamic bank, Hassan (2007) define Islamic bank as “A banking institution which conducts all its operations conforms to Shari’ah, without involving itself and its clients in Riba (interest) in any way”. The International Association of Islamic Bank (IAIB) viewed Islamic bank as banking which implements a new banking concept in that it adheres strictly to the rulings of Islamic Shari’ah in the fields of finance and other dealings. The later definitions incorporate the both aspects of banking and Shari’ah on an equal proportion, as Islamic bank has to fulfill two basic requirements. Firstly its operations must be based strictly on Islamic principles and secondly it must perform the functions of a sound banking. It is therefore indicative that the Islamic bank faces the technical constraints usually imposed on banks and is also subjects to the legal and ethical constraints provided by the Shari’ah (Hassan, 2007). Perhaps Ahsan gives the most comprehensive definition of Islamic bank. Ahsan (1988) defined an Islamic bank as “a financial and social institution whose objectives and operations as well as principles and practices must conform to the principles of Shariah and which avoid the use of interest in any of its operations. It stands for an alternative financial system based on Islamic ideals. It is not only a financier but also a partner in productive”. This definition asserts the main feature of Islamic banks: Multifunction banks, offering all the services rendered by conventional banks, but on an interest-free basis, it promotes profit and loss sharing in all conduct of banking businesses and, most significantly guidance by Islamic Shari’ah through a board of Islamic scholars called the “Shari’ah Supervisory Board” (SSB).

It should be kept in mind that the concept of Islamic Banking and Interest-Free Banking are synonymously used in Islamic Economics and financial literatures as an alternative banking framework to the interest-based conventional banking practice. Although in technical terms, there is a difference between an interest-free bank and an Islamic bank but they are sometimes used interchangeably. (Ibrahim et. al.2015).According to Mannan (1976) cited in Ibrahim et al.2015) Islamic banking is an interest-free financing system essentially based on profit and loss sharing. And its operations are in conformity with Shariah. It is therefore, the cornerstone of the

Islamic banking System which is by definition Interest-Free. In contrary Gusau (2000) argues that “Islamic banking system is supposed to operate completely within the Shariah in all its activities both in sourcing of funds and disbursement of the funds. It not only avoids interest in all its ramifications but also it avoids all other Islamically prohibited activities. Interest-free banking system on the other hand, does not engage in interest but there is no reason to suppose that all its other activities will be done strictly according to Shariah”. All in all, interest-free operation is a necessary but not a sufficient condition for a bank to qualify as an Islamic Bank In addition to non-interest charges, the bank must promote Islamic ideals. (Ibrahim et al, 2015). Deposit without interest and lending without interest does not makes interest free banks including conventional banks Islamic windows comply with the sharia principles which is the basic nature of Islamic banking system. Therefore, Interest-Free Banking can be described as the provision of Interest-Free Banking services by the Islamic banks on the basis of profit and loss sharing (PLS) principles .It is an operational strategy adopted by Islamic banks in which non-interest-based banking services are operated alongside with conventional banking services, for the purpose of meeting increasing demand from customers, improve mobilizations of savings as well as benefit from the new vista of opportunity offered by Islamic banking system. It should be seen as an integral aspect of financial globalization which entails the integration of Islamic financial system with the Western Financial System to produce global financial system (Ibid).

2.1.2. Sources of Islamic legislation

It is essential to understand the source of Interest free banking before the discussion on fundamentals principles and challenges of Interest free banks. In Islam, the faith and daily activities are linked together unlike any other religion (Alamgir et al, 2017). There is no concept of an economy functioning independently of the religious criteria that inform every single aspect of human life (Olanipekun, Brimah, and Ajagbe, 2014). According to Novethic (2009), the principles of Islamic finance and motivations behind Islamic finance as laid down by the Shariah, or Islamic law that is based on the writings of the Qur’an and sayings of the Prophet and which also acts as a framework for different aspects of day-to-day life for Muslims. Since banking is part of daily activities, banking practices are guided by Shari’ah, known as Fiqh al-Muamalat (Islamic rules on transactions). The Shariah is the Divine Law that lists moral, ethical and legal principles and promotes a certain code of behavior described by the Holy Quran and describes or lists both the unwritten and written code of obligations toward every sphere of

human activity. The Shariah includes a set of duties and practices such as prayer, manners, ethics, marriage, conducting business, finance transactions, contracts and other rules of Allah (Szczepanowicz, P.26, 2011). The Shariah also offers several ethical and social criteria for exclusion regarding the investment targets and financial products allowed for Muslims (AAOIFI, cited in Szczepanowicz P.26, 2011).

The rules and practices of Fiqh Muamalat are derived from the Holy Quran, the Sunnah, Ijma, Qiyas, and Ijtihad (Olanipekun et al., 2015; Gait and Worthington, 2009; and Pasha, 2014). Although the classification of these sources as well as their level of acceptance may vary among the Islamic Schools of thought, all schools regard the first two resources as the most important sources of sharia. More specifically, two sources have been identified for Shariah: Qur'an and Sunnah are the primary sources of Shariah. According to Gerrard and Cunningham (1997), the Qur'an (Muslim Holy book), clearly deals with economic-related matters and how they apply in Islam. The Holy Quran also says that commerce and trade includes three basic principles (i) Risk Taking (ghorm); (ii) Work and Effort (kasb) and (iii) Responsibility (Damam) (Pasha, 2014). Furthermore, the Quran contains explicit rules regulating personal status, contracts, property, civil and criminal law, and the economic system. The main prescriptions relating to financial transactions are: the prohibition of riba (i.e. the payment of a fixed or determinable interest on funds); and the prohibition of economic practices that involve the concept of gharar (deceptive uncertainty), maysir (speculation) and harām (prohibited behavior) (Aziz, 2012 cited in Olanipekun et al., 2015). Sunnah generally refers to all that is narrated from the Prophet (PBUH), his acts, his sayings, whatever he tacitly approved, plus all the reports that describes his physical attributes and characters (Kettell, 2011). The Holy Qur'an and the Sunnah of the prophet, which is known as Al-wahyain (the two revelations), are the only primary sources of Islamic law (shafi'i, 1940 cited in Baej, P.9, 2013).

The secondary sources are opinions collectively agreed among Shariah scholars Ijma, Qiyas and Istihad. These secondary sources are Islamic jurisprudence (fiqh), based on the interpretations (Istihad) of experts in particular cases (e.g. ones of implicit or unclear rules), on deductive reasoning (qiyas), (Abedifar, Molyneux, and Tarazi, 2012) and on the expert consensus of various schools of thought (ijma') (Aggarwal and Goodell, 2009).

2.1.3. Fundamental principles of Interest free banking

Islamic banking is commonly defined as a form of banking system which operates without the norm of interest. In fact, the one most common fact known about the Interest free banking is banning profit by obtaining bank interest, the prohibition of interest is not the only distinction but there are some other salient features which constitute the structure of the framework of Islamic banking. Many scholars have studied the core principles of Islamic finance including interest free banking. The fact that Islamic laws prohibit Muslims from paying or receiving interest; prohibit Gharar, encompassing the full disclosure of information, removal of asymmetric information in contracts and the avoidance of risk-taking; exclusion of financing and dealing in activities and commodities regarded as sinful or socially irresponsible (such as gambling, alcohol and pork); an emphasis on risk-sharing, the provider of financial funds and the entrepreneur share business risk in return for a pre-determined share of profits and losses; the desirability of materiality, a financial transaction needs to have ‘material finality’, that is a direct or indirect link to a real economic transaction; any transaction leading to injustice and exploitation is prohibited; and upholds contractual obligations and the disclosure of information, which in turn reduces the risk of asymmetric information and moral hazard (Alamgir et.al, (2017), Iqbal and Molyneux (2005), Gait and Worthington (2009) and Abdul-Gafoor (2003)). The following sections discuss and distinguish some principles of Interest free banking or Islamic Banking system.

2.1.3.1. The prohibition of riba

Riba which is the same thing as interest has been defined differently by different scholars (Bello and Abubakar, 2014). Some of these scholars see it to mean the same thing, while some try to differentiate it from interest charged in the conventional banking on a loan. According to Baej (2006) Riba is an Arabic word that, in general, has verbal and conceptual meaning. The literal meaning of the word is the increase’ or the growth. However, the term is specifically used by Shariah jurists and scholars to refer to either Riba al Nasi’ah which means Riba of delay or Riba al fadl. Riba al Nasi’ah means the excess over capita in a loan in exchange for a delayed period of payment (Albalawi, 2006, p.55 Cited Baej, 2013). It also refers to the practice of lending money for any length of time on the understanding that the borrower would return to the lender at the end of the period the amount originally lent together with an increase on it, in consideration of the lender having granted him time to pay irrespective of loss or profit (Bello and Abubakar, 2014). Whereas Riba al- fadl associated with quality in direct exchange of

commodities. It means the quality premium in exchange of low quality with better quality commodities. The concept of Riba al-Fadl refers to sale transactions (Ibid). Baej(2013) said that it can be best described by an example from the Sunnah of the prophet Muhammad PBUH: “ Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, like for like, same for same, hand to hand (Muslim:2917). Interest, in all modern banking transactions, falls under Riba al-Nasiah. In the current banking system, as money is exchange for money with excess and delay, it falls under the definition of Riba which has been prohibited in Islam no matter the name you call it (Bello and Abubakar, 2014).

Islam, like other monotheistic religions, condemns and prohibits Riba. The prohibition of Riba in Islam is given in strong and clear-cut terms (Kahf, 2009). The prohibition of riba is mentioned in four different revelations in the Qur'an and Hadith (saying and deeds or tradition) of the prophet Muhammad PBUH. The first verse is in Surah Al-Rum 30:39 emphasizes that interest deprives wealth of God's blessings. The second verse is in Surah An-Nisaa 4:161 condemn it, placing interest in juxtaposition with wrongful appropriation of property belonging to others. The third verse is part of Surah Al-i-'Imran 3:130 enjoins Muslims to stay clear of interest for the sake of their own welfare. The last revelation is reported in Surah Al-Baqarah 2:275 whereby establishes a clear distinction between interest and trade, urging Muslims to take only the principal sum and to forgo even this sum if the borrower is unable to repay.

Mostly the people who are unaware of the Shariah and its economic philosophy are of the view that if interest is abolished from the financial institutions, it will make them charitable institutions rather than commercial, which will offer financial services without any return (Shah, Raza and Khurshid, 2012). This is a completely wrong assumption. The Islamic ban on interest does not mean that capital is costless in an Islamic system. Islam recognizes capital as a factor of production but it does not allow the factor to make a prior or pre-determined claim on the productive surplus in the form of interest (Ariff, 1988). In Shariah interest free loans are only for charitable activities not for the commercial transaction except in very partial range. In case of commercial finance, Shariah has different lay down of procedures. If a person gives money to another person he must decide whether he wishes to help him or wants some share in the profit. If he wants to help the borrower, he must not claim any additional amount other than his principal amount. But if he gives money to share the profits earned by the other party, he must

share the profit as well as loss (Shah et al., 2012). Therefore, it is obvious that exclusion of interest from the financial institution does not necessarily mean that the financier cannot earn profit (Usmani, T 2004).

2.1.3.2. The prohibition of Al-Gharar

Islam considers the performance of contractual obligations as an important duty of parties of the transaction. These requirements are intended to reduce the risks associated with asymmetry of information and moral hazard. This tenet basically implies to the fact that business transactions involving elements of speculation (gharar) are also condemned by Islamic shariah. Gharar refers to entering into a contract in absolute risk or uncertainty about the ultimate result of the contract and the nature and/or quality and specifications of the subject matter or the rights and obligations of the parties. Gharar is also involved if there is a lack of adequate value-relevant information or there is inadequacy and inaccuracy of any vital information which leads to uncertainty and exploitation of any of the parties (Ayub, 2007). It actually refers to the offer and sale of things whose presence or qualities are not sure, or a sale including a high degree of risk and uncertainty (Ibid). In business terms, gharar means to undertake a venture blindly without sufficient knowledge or to undertake an excessively risky transaction, although minor uncertainties can be permitted when there is some necessity. In a general context, the unanimous view of the jurists holds that in any transaction, by failing or neglecting to define any of the essential pillars of contract relating to the consideration or measure of the object, the parties undertake a risk which is not indispensable for them. Such risk is deemed unacceptable and tantamount to speculation due to its inherent uncertainty (Lewis and Hassan, 2004). Generally Ghara translated as hazard, risk and uncertainty, it is mostly understood in the light of its examples found in the Sunnah of what was actually regarded as gharar by the Prophet (PBUH). Selling fish while still in the pond, actual quantity of the catch unknown, or an unborn animal still in its mother's womb, was prohibited (Siddiqi, 2006). Since Islam prohibits speculation and most of the Islamic banking products are based on concepts of Islamic contracts, a potential Islamic bank will avoid all transactions with excessive risk.

2.1.3.3. The prohibition of Al-Maysir

Islamic banks are financial institutions that are there to provide support for economic activities that are ethically, morally and lawfully right (Honohan, 2001). The shari'ah determined that in

the interests of fair, ethical dealing in commutative contracts, unjustified enrichment through games of pure chance should be prohibited (Lewis and Hassan, 2004). The name for that in Islam sharia is maysir. A prohibition on games of chance is explicit in the Holy Qur'an which uses the word maysir for games of hazard, implying that the gambler strives to amass wealth without effort, and the term is now applied generally to all gambling activities. Gambling in all its forms is forbidden in Islamic jurisprudence (Ibid). Islamic law also forbids any banking activities which contain any element of gambling.

2.1.3.4. Prohibition of Unethical Investments

Islamic banking is a banking system that is based on Shari'ah. To be acceptable from a Shari'ah point of view, a finance product must be morally sound. This is a general human standard preached and adopted by the Shari'ah. It means that an Islamic financing institution can't use its resources to support the production or distribution of specific activities which are forbidden by Islam. That is, investments in unethical or immoral sectors such as alcohol, gambling pornography, environmentally harmful products, and/or any other production or distribution of any material or service that does not have a humanly acceptable ethical foundation. So any transactions that are prohibited by Shari'ah are avoided in Islamic banking. Islamic banks can only partake in transactions or activities that are approved by the Shari'ah board or advisors.

2.1.3.5. Profit and Loss Sharing

Since Islam prohibits dealing with Interest, alternative which has been mentioned is the trade. Sharia based transactions means the financing modes adopted by Islamic banks on profit and loss sharing basis including Musharaka (partnership in capital) and Mudaraba (partnership of capital and skill). Under Sharia based modes of financing returns of financier are not fixed in advance rather it depends upon the outcome of the project. Instead of having a fixed amount of Interest, risk as well as profit in Islamic finance should be shared between the two parts (the lender and borrowers) of financial contracts which called profit and loss sharing (Gaint and Worthington, 2009). Due to the profit and loss sharing aspects of some Islamic finance techniques, it can also enable poor entrepreneurs to gain access to funding to set up their own businesses, without providing the necessary collateral that may be requested in the conventional banking market.

2.1.3.6. Asset-backed banking Transactions

A common theoretical aspect of all Islamic banking financial products is that they are asset-backed. Investment activities of Islamic banks have been favourably skewed towards the real sectors of the various economies in which they operate. Interest free banks cannot extend credit facility without having support from real sector. Financing is either made through sharing risk and reward or must be asset backed. By far the most impressive argument in favor of Islamic finance has been that it integrates the financial sector with the real sector. The debt propelled conventional system fails to do so. In the Islamic financial system there is an existing or potential real asset corresponding to every financial asset. Not so in the conventional system in which financial assets based on or derived from other debt based financial assets go on multiplying, making the system more vulnerable to speculation leading to instability. Instability originating in the financial sector spreads to the real sector affecting balance of payments, employment, production and living standards.

2.1.4. Operating Models of Interest Free Banking

The remarkable success in the operation of Islamic banking system in both Muslim and non-Muslim countries within the short period of its existence proved beyond reasonable doubts, the viability and prospects of the scheme in the contemporary global economy (Ibrahim et al.,2015).In addition, there are many countries interested in introducing Islamic banking in their banking systems. In order to do so, they are considering three operating models namely Full-fledged Interest free banking, Interest free banking branch (subsidiary) of conventional banks, Interest free windows of conventional banks. Some countries like Malaysia and western countries allow conventional banks operating in their jurisdictions to have Islamic banking services through Islamic banking windows while countries in the Middle East prefer an Islamic banking subsidiary. For example, Qatar banned conventional banks in the country from offering Islamic windows in 2011 (Farook, 2011). Ethiopia, on the other hand, provides an interesting example of a country that allows Islamic banking only in the form of Islamic Windows. Apart from the first product which seems to speak the mind of an Islamic bank, the last two options indicate the overlapping cooperation between Islamic and conventional financial institutions in managing investments while scholars are not unanimous about the permissibility of the last two

options. This section provide an explanation of each operating model by differentiating it one from another, it explains the concept, basic features, modes of operation, advantage and disadvantage of each operating model of interest free banking .

2.1.4.1 Full-Fledged Interest Free Banks

These are standalone banks that generally are not under any conventional banking influence. The products and services may be consistent with the offerings in the market, but it is not an obligation to follow. In theory, Full Fledged Islamic Banks have the capacity to offer new-to-market products, based on the approvals obtained from Shariah Committees.

2.1.4.2. The Islamic Subsidiary Model

Islamic banking subsidiary is defined as Islamic banking products and services offered by subsidiaries of conventional banks, but the operation and management of the two are clearly separated (Sole, 2007). Islamic Subsidiary rides on the strength of the Parent Bank, which is the conventional bank. The model used is still a leveraged model, but the Islamic Subsidiary can choose which services or function they want to “outsource” to the conventional bank (at a fee chargeback, of course). The idea of a Subsidiary is to be independent, so all cost consideration must be taken into account. Rosly (2005) is in the opinion of favoring Islamic banking subsidiaries over Islamic banking windows. He highlighted some disadvantages of Islamic banking windows that can be addressed by Islamic banking subsidiary such as mixing reserves between Islamic and conventional banking operations and financial reporting issue especially with regards to capital adequacy and full disclosure of Islamic investments. However, being a Subsidiary Bank can also be a burden to set-up. A differentiated system or process or operation team requires cash for its set-up. At the early stages, such investment cash will be limited, and when cash is available for investment, the development of the Subsidiary Bank must then align with the conventional bank. Rosly (2005) also highlights some challenges that need to be addressed in opening Islamic banking subsidiary such as higher overhead expenses and smaller marketing network.

Most of the conventional banks offer Islamic products via Islamic Banking Subsidiary. The main advantage is that decisions are autonomous in a Subsidiary, there is more control of marketing and sales and branches, and the Bank (as an independent entity) can chart its own course.

However, there will still be influence from the parent (as the majority shareholder) and the products and services offered are generally aligned to the products and services offered by the parents. The Subsidiaries are also dependent on the strategy of the parent Bank, where it can choose to invest heavily or adequately for the operations of its subsidiary.

2.1.4.3. The Interest Free Banking Window Operating Model

Sanusi (2011) defines Islamic banking window as a business model in which conventional banks offer Islamic banking products and services from their existing network. This model relies on the existing conventional infrastructure where all the processes, operations, sales, channels, finance, branches, compliance, audit and all functions are provided by the conventional bank. It is a leverage model where the Islamic Banking Windows are more like a “manufacturer” of products. Islamic Banking Windows churn out the products and services (like a factory), and delivers them to the conventional team as part of the suite of products offered by the conventional bank. In such structure, Islamic Banking Windows are just a “segment” of products on offer.

The advantage of this model is the low set-up cost. The business rides on existing infrastructure and hires specialists in each function. There is no need to set up a different branch as those Islamic products are sold directly by the existing branches and channels sales team. In terms of efficiency and other economic benefits, an Islamic banking window is found to be preferable especially in the early phase of Islamic banking industry development (Hidayat and Al-Khalifa, 2016). Sole (2007) also identifies several advantages of offering Islamic banking services through Islamic banking windows such as the bank can use its existing infrastructure and network to offer Islamic banking products. However, possible comingling of funds has been identified as a disadvantage of Islamic banking windows.

2.1.5. Shariah Requirements for conventional banks

The considerable growth of Islamic Finance in the emerging markets as legitimate alternative to conventional products has triggered the interest of most of conventional financial institutions to adopt a dual-banking system and undertake Islamic financial activities to meet the demands of its clients seeking Shariah compliant products/services (Mustafa, 2016). Some scholars believe that this is not permissible, because conventional financial institutions do not comply, in the first

place, with the sharia in terms of their incorporation and statutes. On the other hand, there is a group of contemporary scholars who permit this type of investment product as long as the sharia conditions laid down for them are satisfied(Yaquby,2000). According to Yaquby the most important of these required conditions are: complete segregation of funds; the existence of a Sharia supervisory board; management committed to Islamic financial concepts; safeguarding Muslim investors' funds from negligence, trespass, and fraud; and compliance with the standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

2.1.5.1. Complete Segregation of Funds

The funds of the Islamic investment product and those of the financial institution in which sharia provisions are not observed must be completely segregated. The funds of investors who are very diligent and anxious to earn lawful income should not be commingled with those of conventional investors who are not observant of the sharia. Therefore, there should be separate accounts, books, and computer programs evidencing this complete segregation of funds. This matter is not difficult or problematic in view of the availability of modern computer systems, assuming that intentions are sincere and the required expertise is available. This compliance should be enshrined and expressly stated in the statutes or the prospectus.

2.1.5.2. Sharia Supervisory Board

There should be a sharia supervisory board for any institutional Islamic investment body, and that Board should consist of trustworthy scholars who are highly qualified to issue fatawa (religious rulings) on financial transactions. In addition, they ought to have considerable experience with knowledge of modern dealings and transactions. The Articles of Association, prospectuses, or statutes (depending on the type of activity) should provide for the existence of a sharia board, whose fatawa and resolutions should be binding upon the financial institution's management. It should be independent and free to give opinions on proposed contracts and transactions. The role of the sharia supervisory board should be concurrent with that of the financial institution itself in the sense that it should be formed from the moment the financial institution is incorporated, and that it should provide continued supervision and permanent checking of contracts, transactions, and procedures. This should be expressly provided for in the Articles of Association or the prospectus.

2.1.5.3. Managerial Commitment

The financial institution's management, which is undertaking such business activities should be fully convinced of the concept and fully committed and dedicated to it. It should be anxious to implement it and comply with the teachings governing it. Unless the entire management is committed and convinced, the business activities and the enterprise will not be foul free or will not escape irregularities and deviation. Regardless of how strict and stringent fatawa and contracts are, this will not ensure sound practices if there is no one sufficiently sincere and committed to implement the principles. However, there is no harm in starting first with the executive senior management, which implement resolutions and subsequently trains the other members of the administrative team. The general manager himself should act as a springboard and set a good example for all in this respect.

2.1.5.4. Safeguarding Muslim Investors' Funds

It is an established principle in Islamic law that the mudarib does not guarantee the mudaraba capital for the capital provider. Hence, investment accounts in Islamic financial institutions are not guaranteed by the mudarib. However, this does not prevent the laying down of a stipulation requiring that the parent conventional financial institution (the original company) guarantee Muslim investors' funds against trespass, negligence, and fraud. Major financial institutions may sometimes shirk their responsibility in this connection by claiming that their Islamic windows, branches, or sections are privately incorporated, among other reasons and excuses. This is wholly unacceptable. Precautions should be taken to guard against this, and a similar policy should be expressly stated in the articles of association or the prospectus of the financial institution.

2.1.5.5. Compliance with AAOIFI Standards

The Accounting and Auditing Organization for Islamic Financial Institutions has issued and published a number of accounting and auditing standards that all Islamic financial institutions should comply with and implement. The AAOIFI's activities are considered a fundamental groundwork that underpins Islamic banking activities by keeping them away from individual, personal reasoning. The collective personal reasoning (ijtihad) of the AAOIFI is highly important in this vital aspect of Islamic economic life. Therefore, these standards deserve strict adherence. A number of government authorities and central banks in certain countries have

circulated these standards and obliged other financial institutions to comply with them. That is why any party wishing to incorporate or set up an Islamic financial institution should be required to conform to these standards in order to avoid confusion, misunderstanding, and ambiguity, and to seek clarity and sound business activities.

2.2. Empirical Literature Review

Substantial amount empirical studies on Issues and challenges of Islamic banking have been conducted all over the world especially in the context of countries that have adopted the system and practices over the years of its evolution to enhance the establishment and operation of Islamic banking. Eventhough these studies discussed the theoretical and practical aspects of interest free banking, some of these studies are based on a single country experience and some of them based on the general system of Islamic banking. It is the conclusion of many studies from both single country as well as general studies on challenges of Islamic banking that the establishment of Islamic banking in any country be it Muslim or non-Muslim faces a number of challenges, but they are not without remedies. In these sections the researcher reviews country-specific studies and general system on the challenges of interest free banking.

2.2.1 Studies related to Islamic banking in country specific studies

Ahmad (2008) looked into the opportunities and major challenges noted in the UK Islamic banks. Data was collected through in-depth interviews of different groups including banking authorities, customers and non-customers of Islamic banking. The study found considerable opportunities for the Islamic banking system to grow and develop in the U.K. Added to the above, the study also revealed some barriers to such growth and they include the state of the service network related to Muslims across the U.K., the lack of Islamic banks and institutions that fully satisfies the whole Muslim community, the lack of harmonization of the accounting system, and the lack of qualified employees that are skilled in Islamic financial products, marketing and sales. In a related study, Ringim (2013) studied the understanding of account holders in conventional banks toward Islamic banking products, and conducted a survey of over 300 Muslim clients in the UK on Islamic windows by conventional banks and found that Muslim clients are not fully aware of Islamic banking products.

Jabr (2003) explore the challenges and prospects of Islamic banks operating in the Palestinian territories and he conclude that challenges of Islamic banks are as follows: Lack of adequate

banking law for Islamic banking; existence of unproductive money; lack of awareness; lack of operational difference between Islamic and conventional banks; Islamic banking lacks the ability to channel deposits into long-term investment; lack of experience in Islamic Shari'ah; excessive short-term financial instrument; inability to make use of Mudaraba and Musharaka financial institutions; inferior technical resources and technology; Islamic banks are compelled to recruit staff trained in traditional banking; inability to differentiate ownership from management; and lack of financial innovations.

Sarker (1999) investigated the Islamic banks achievement and challenges in the context of Bangladesh and highlighted the following challenges ; lack of an interest-free mechanism for the short-term replacement of funds, high risks in profit-sharing, and of the investments in Islamic banks are made on a mark-up basis through Murabaha and Bai'-Muajjal. This indicates that the concentration of the short-term trade investments of Islamic banks is a crucial issue to be addressed in Islamic banks in Bangladesh. The barriers also include the lack of a full-fledged legal framework for Islamic banking, lack of trained and efficient human resource committed to Islamic banking, and the absence of Shari'ah compliant regulatory and supervisory standards. The study also recommended that micro, small and medium enterprises should arrange their priorities of when it comes to investment decisions in Islamic banks – more specifically, the quality of manpower in such banks has to be upgraded to enhance their performance.

Bello and Abubakar (2014) categorized challenges Interest free banking in Nigeria into institutional and operational obstacles. The institutional obstacles include: inappropriate institution framework, inadequate legal framework, lack of equity institution, poor supervisory framework, and disparity in accounting standard, lack of short-term financial instruments and institutions and absence of secondary financial market. They identified the operational challenges to include religious, and cultural differences, inadequacy of financial innovations, lack of profit sharing finance, sharia related issues, inadequate human resources, inadequate awareness and competition.

In addition, in the context of Nigeria, Sanusi (2011) explores the issues and challenges of Islamic banking. The study finds that the challenges of Islamic banking in Nigeria are inadequate manpower, lack of Shari'ah – compliant liquidity management instruments, lack of Islamic

insurance (Takaful), lack of knowledge of accounting and auditing standard require by Islamic financial institutions, inadequate legal framework, lack of Shari'ah scholars knowledgeable in conventional economics, law, accounting, banking and finance, problem of multiple taxation, lack of tax relief on Islamic banking profits, and misperception of Islamic banking in Nigeria.

Abdalla, Aziz, and Johari, (2015) examined the validity of successful conversion of conventional banks to Islamic banks based on the Libyan model and the factors that affect the conversion. They examined four independent variables namely the availability of qualified human resources in Islamic banks, the availability of Islamic capital market, the employees' willingness to convert to Islamic banks, and the success of the Islamic banking experience, and a single independent variable namely the success of the experience in converting into Islamic banks. They adopted the quantitative method to collect data and found that all the tested factors positively influenced successful conversion into Islamic banks in Libya.

Ibrahim et.al (2015) sought to identify operational challenges of Interest-Free Banking Window in Nigeria with particular reference to the Non-Interest Banking (NIB) of keystone Bank limited in Nasarawa State. A sample of 150 respondents, consisting of 30 staff and 120 customers were sourced via structured questionnaires. The data was analyzed using chi-square and binary logit model. The research findings revealed that legal frame work; Manpower, Competition, Financial Literacy, Religion and Moral Hazard constitute significant constraints on the operation of the Interest-Free Window.

Saleh and Zeitum (2005) examine the Lebanese experience with Islamic banking since the foundation of the first Islamic bank. They find that lack of public awareness and acceptance, lack of research and development institutions, inadequate manpower, and high competition from conventional banks offering Islamic windows are the major challenges of Islamic banking in Lebanon. They were however, optimistic that Islamic banking in Lebanon will prosper because of its ability to attract more investment and capital into the country, the vital role it plays in financing and developing telecommunications, agriculture, industry sectors in the Lebanese economy, its long term strategy to increase its customer base, and its current support from the general public as well as private business.

In Iqbal' et al. (1998) study, focused on the Challenges Facing Islamic Banking. They opine that the challenges hindering Islamic banking are institutional as well as operational challenges. The institutional challenges are poor institutional framework, inadequate legal framework and supervisory policies, poor supervisory framework, disparity in accounting standards, lack of equity institutions, absent of organized secondary financial market, and lack of short term market placement of funds. While the operational challenges are improper financial engineering, lack of teaching, training, research and development in this institution, lack of profit sharing finance, inability to adequately mobilize deposits, competition, and finally globalization.

Iqbal (2001) opines that the challenges facing Islamic financial industry are limited set of short terms financial instrument and inadequate medium – to long – term financial instruments, limited coverage of Islamic finance, concentration of Islamic banking, poor risk management and governance framework, and difference between Islamic finance in theory and in practice. The author recommends adequate risk management and diversification of the institution, provision of non – banking financial services, and development of capital markets that are Sharia inclined to improve its activities and functions, and be able to compete favourably. Pasha (2014) discussed the role and progress of Islamic banking, where he showed that the growing awareness of Islamic banking is attempting to provide interest free banking services using separate windows in India and Ethiopia.

In short, from both single country as well as general studies on Islamic finance, one can conclude that the importance of adequate human resources qualified in Islamic and conventional settings, financial innovations, awareness, adequate provision of both short- and long-term financial instruments, proper Shari'ah regulating body, adequate legal framework, proper institutional framework etc.

2.2.2 Studies related to Islamic banking in Ethiopia

As far as the interest free banking in Ethiopia is concerned, there have been very limited studies. There have been some studies concerning the introduction of Interest free banking in general and Full-fledged Islamic banking in the Ethiopian environment. Yet, these attempts have not been taken into consideration by the policy makers in the country. An Example was a study conducted

by Mohammed (2012) as part of fulfilling the requirements of a Master's degree entitled: 'Islamic Banking: prospects, opportunities and challenges in Ethiopia'. Result show that lack of awareness, regulatory and supervisory challenges, institutional challenges, lack of support and link institutions, gap in research and development in Islamic studies as, lack of qualified human resource as well as wrongful association with specific religion and the global terrorism movements in recent times has been reported as one of the major problems facing Islamic banking in Ethiopia.

Another study conducted by Kumar (2009) entitled: 'the potentiality of Islamic banking in Ethiopia: The Islamic Society's perception in Jimma'. The survey result show that 90% of sample respondents are in favor of an Islamic Bank but, 66% is of the opinion of a separate Islamic bank, 12% prefer Islamic branches of cooperative institutions. Islamic branches of conventional banks and Islamic branches of MFIs are preferred by only 6%.Both these studies shows the potentiality and the prospects of interest free banking in Ethiopia and there is a significant demand of Islamic banking in Ethiopia. However, the current directive only allowed conventional banks Islamic window to operate interest free banking not a stand-alone Islamic banks.

Operating Islamic window and/or subsidiary in conventional banks seems to be a well-known way of introduce the Islamic banking to conventional banking system. Ethiopia does not have ample experienced in dealing with Islamic window of conventional banks. In other words, the IFB by conventional banks is a new event in Ethiopia as evidenced by only few conventional banks offering interest free banking products and services along with conventional products in the past seven years. In the context of Ethiopia, the information on the practices and challenges of interest free banking and findings on different issues of interest free banking have been made available through limited research activities only in recent years. For example, Debebe (2015) in his study entitled as Factors Affecting Customers' to Use Interest Free Banking in Ethiopia showed that perceived relative advantage, perceived compatibility, customers' level of awareness and subjective norm have a significant positive impact on the attitude towards interest free banking in commercial bank of Ethiopia.

In addition, Teferi (2015), in his study entitled as Contribution of IFB to economic development and its prospects in Ethiopia. IFB plays a vital role in idle monetary resource mobilization and allocation, inviting to use banking system, creating employment opportunity, supporting GDP growth and assisting in stabilizing crisis and arresting inflation. Moreover, IFB is deemed to play an integral role in Ethiopia in catalyzing the economic development subject to adequate awareness creation about its governing principles, compliance with prohibitions, familiarity with operating philosophies, expertise capacity building of operators-bankers, experience sharing from Islamic banking-pioneering countries, and devising enabling regulatory environment.

Another important study conducted by Kerima (2016) investigated Challenges on Interest Free Banking Services: The Case of Commercial Bank of Ethiopia. Empirical result show that lack of commitment of the bank, lack of Shariah advisor, lack of supportive regulatory directives , Problem related to Ethiopian Commodity Exchange (ECX) law, lack of capacity to deliver IFB product at full rage, lack of awareness of customer about IFB products, lack of trust and confidence of customers, inadequate marketing and promotion, double taxation, nature of IFB products, unavailability of IFB products in all of its branches and the IFB being delivered in a Window model are the major obstacles for the operation of IFB for the bank.

Since the concept of Islamic windows by conventional banking is new, there is deficiency in literature especially in the context of Ethiopia. Identifying existing and possible challenges could be beneficiary for the development of the service as an industry and lesson for banks currently offering the service and those banks intended to offer the service in the future. Hence, this study is expected to contribute to the body of knowledge in the field of Islamic windows in Ethiopia.

2.2.3 Research Gap

Based on the foregone review of literature, it becomes clear that previous studies, which either focuses on the challenges and prospect of establishing full-fledged Islamic banking or challenges of customer using IBF or case study on the challenges of IFB particular conventional bank. This study attempted to know the challenges and sharia compliance of Interest free banking window managed by conventional banks in Ethiopia and to evaluate them critically.

CHAPTER 4

Research Methodology and Design

The study aims to describe practices and challenges of Interest free banking with in Commercial banks. In addition, it also aims to examine the sharia compliance of the current Interest free banking products and services with detailed analysis of the operations of Islamic window of Commercial banks. Consequently, the study attempts to provide a clear picture about challenges Interest free banking within Commercial banks in Ethiopia and to suggest possible ways to improve Interest free banking and Islamic windows of Commercial banks'. In fulfilling these objectives, formulating the research problem is the first important step in the research process. The second important step is to decide on a system of methods to follow in conducting the research, which is called methodology (Kumati, 2008). Research methodology forms a critical component of any research activity. It is the part of a study that encapsulates processes, methods and design (i.e. approach, choices and philosophy) with which the study is conducted. It is the means by which the research problem is scientifically addressed including the logic underlying them (Kothari as cited Quansah, 2004). This chapter discusses the research methodologies employed to answer the research questions. It outlines the study design, the target population, sampling methods and sample size, data collection methods, and data analysis techniques.

3.1 Study Design

As rightly noted by (Yin, 2009) every type of empirical research has implicit research design. In most elementary sense, the design is the logical sequence that connects the empirical data to a study's initial research questions and ultimately to its conclusion. In this study, the researcher attempts to describe the challenges faced by conventional banks Islamic windows. Therefore, this research conducted in a descriptive study design approach. Descriptive research is concerned with conditions and relationships that exist; practices that prevail; beliefs, point of views and attitudes that are held; processes that are going on; effects that are being felt; or trends that are developing. At times, descriptive research is concerned with how, what is or what exists is related to some preceding event that has influenced or affected a present condition or event' (Best, 1970). The study adopted mixed research design in order to achieve the stated research objective and to answer research questions. It allows for both quantitative and qualitative data to be gathered and analyzed using their respective quantitative and qualitative techniques. Specifically, the study used quantitative survey and qualitative in-depth interview. The survey

conducted with customers of IFB, staffs of IFB windows and department while the in-depth interviews conducted with managers of IFB department or division.

3.2 Source of data

For accomplishing the research work and research objectives, study used both primary and secondary data. The primary data sources were staffs of IFB division/department and branches of Commercial banks in Addis Ababa, the heads of IFB department or division. In an effort to make the research more valid and credible secondary data was used for the issues raised on the research question. Secondary data was collected from different journals, articles, books, postgraduate theses and dissertation, conference papers, web pages, directives, and annual reports of Commercial banks related to Islamic banking practices. By referring to the previous literature, the information about the challenges of IFB and the method of minimizing these challenges identified.

3.3 Population

Population is a large number of objects and more precisely it is called ‘universe’ from which the researcher is collecting information (Goddord & Melville, 2004). In research, the word ‘population, refers to “the abstract idea of a large group of many cases from which a researcher draws a sample and to which results from a sample are generalized” (Neuman, 2011, P.241). For the purpose of fulfilling the research’s main objective, that is to describe the practices and challenges related to interest free banking and Shari’ah compliance of Interest free banking windows of conventional banks, it is necessary to focus on the Commercial banks currently offering interest free banking product and services through dedicated windows. Interest free banking windows of Commercial banks are suitable as the study population for the following reasons: first, IFB in Ethiopia currently offer only through Interest free banking windows; second, the practice of Interest free banking windows of Commercial banks would be reflective of IFB operations in the country since their IFB window is only an arm of IFB operations in the country. At the end of 2017, there are seventeen commercial banks operating in Ethiopia banking industry (www.nbe.gov.et). Ten out of seventeen offering Interest free banking products and services, namely: Abyssinia(AbB), Abay Bank (AB), Awash International Bank (AIB), Commercial bank of Ethiopia (CBE), Cooperative Bank of Oromia (CBO), Dashen Bank(DB), Nib International Bank (NIB), Oromia international bank (OIB), United Bank (UB) and

Wegagen Bank (WB). Thus, this study attempts to cover all Commercial banks offering Interest Free banking products and services to examine the nature of these windows and try to achieve the aforementioned objectives.

For the purpose of this study, Interest free banking windows of Commercial banks in the Addis Ababa city are chosen. The representative and officers of Islamic units that is exclusively dedicated to interest-free banking within banks, branch managers of the selected branches, and retail customers of all Commercial banks offering Islamic banking products and services in the Addis Ababa city represent the actual population for this study. The reason why Addis Ababa city is chosen is three-fold. Firstly, it is because Addis Ababa city have a significant number of IFB customers next to Dire Dawa for most banks. Secondly, it is where IFB units that are exclusively dedicated to interest-free banking are found; thirdly, constraints of distance and time available for the study. Due to these, the researcher focuses on IFB windows of the above banks in the Addis Ababa city. It is believed that data gathered with respect to Islamic windows' current status, issues and challenges in relation to the practice of IFB would be reflective of their wider operations in the country.

3.4 Sampling methods and sample size

3.4.1 Sampling methods

It is always difficult or more often it is impossible to approach the entire universe of the population and collect the data due to some operational problems and practical issues (Creswell, 2009). The research practitioners made it simple and practical for the sake of convenience to make general findings based on a study of only a subgroup or subset of the population. The subgroup or subset of the population which is representative of the entire population in terms of characteristics and features to give the true and accurate information about the entire population is called a sample. Welman and Kruger (2001) argue that researchers rely on their experience, ingenuity or previous research findings to deliberately obtain units of analysis in such a manner that the sample they obtain may be regarded as being representative of the relevant population. To ensure this degree of representation, the sample selected from four different categories of groupings. Namely, commercial banks with interest free banking, branches of Commercial banks, the IFB customers, and branch managers of the selected branches. For this particular study, the researcher used multistage probability and nonprobability sampling techniques for

both types of data collection through questionnaires and structured interviews. More specifically, the Sampling of representative samples based on a mix of Stratified sampling, convenience sampling, and purposive sampling. These sampling techniques used due to constraints of time, financial resources and distance among branches. These techniques have been adapted from previous Interest Free banking studies (Debebe A, 2015; Kerima A., 2016; Mohamed M., 2012; and Teferi M., 2015).

The study used a sample of seven commercial banks with Islamic window which did launch the service at full scale (not at pilot stage). Thus, the samples used for this study would be slightly less than the population. This is because; some banks (i.e. Abyssinia, Awash and Dashen) have to be excluded since Islamic windows of these banks were not fully operational. Therefore, the researcher used the technique of purposive sampling to excluded Islamic windows which were established after October 31, 2017 from the sample of this research. The result is that seven Commercial banks with Islamic window qualified to be included for this research. Specifically, study sample covered the following banks Islamic window: Abay Bank, Commercial bank of Ethiopia (CBE), Cooperative Bank of Oromia (CBO), Nib International Bank (NIB), Oromia international bank (OIB), United Bank (UB) and Wegagen Bank (WB).

The research employed stratified sampling in selecting samples (i.e. branches' of conventional banks, IFB customers and branch managers of selected branches). In order to determine the due proportion among the Islamic windows of conventional banks under study, the stratification process can be done either by using proportionate or disproportionate stratified sampling. According to Hair, Joseph, Money, Samuels, & Mike, (2007), in a proportionate stratified sampling, the number of elements chosen from each stratum is proportionate to the size of particular strata, relative to the overall population size. On the other hand, disproportionate stratified sampling independently determines the sample size from each stratum without considering the size of the stratum relative to the overall sample size. This research applied proportionate stratification that is based on the stratum's share of the total population to come up with the sample in each stratum. Simple random sampling method employed to select the actual branches' and branch managers of selected branches under study from each category of strata groups.

3.4.2 Sample Size Determination

The determination of sample size is an important part of a research process. The decisions about sample size is influenced by many factors that need to be taken into account. The factors include the cost and time constraints, variability of elements in the target population, required estimation precision and whether the findings are to be generalized and, if so, to what degree of confidence (Hair et al., 2007). The general rule for sample size is that the larger it become the more accurate the estimation will be (Kumer, 1999). Even though, there is no straightforward answer to the question regarding sample size, there are number of statistical formulas available to calculate an appropriate sample size. For this particular study, sample size decision is made on a case-by-case basis, considering the variety of goals to be achieved by the particular study group and taking into account numerous other aspects of the research design.

Carvalho (1984) method of sample size determination and adopted by Debebe (2015) and Kerima (2016) used to obtain the desired sample size of branches offering interest free banking products and services in Addis Ababa city and branch managers of these selected branches. At the end of 2017 there were 675 branches 7 banks currently offering interest free banking products and services in Addis Ababa city. The numbers of branches in bank were taken from their official websites.

Table3.1 Sample size determination

N	51-90	91-150	151-250	281-500	501-1200	1201-3200	3201-10000	10000-35000	35001-150000
Small	5	8	13	20	32	50	80	125	200
Medium	13	20	32	50	80	125	200	315	500
Large	20	32	50	80	125	200	315	500	800

Source: Carvalho (1984)

Based on this sample size determination method the researcher selected a large sample size which is 125 branches of seven Commercial banks in Addis Ababa city out of total bank branches (675) to increase the accuracy of the data. Since the number of branch in each bank is unbalanced, the researcher split his sample into seven sub-samples. The number of branches

chosen from each bank is proportionate to the size branches of particular bank, relative to the overall population size. After sample size and the number of branches from each bank determine, Simple random sampling method utilized to determine specific Islamic windows of Commercial banks that should covered by the study.

Table 3.2: Sample size of each bank

Subgroups	Number of branches	IFB staff	Percentage of population	Sample size	Percentage of sample
CBE	219	15	32%	40	18%
CBO	60	12	9%	11	18%
OIB	69	14	10%	13	19%
Wegagen	78	2	12%	14	18%
Abay	48	4	7%	9	19%
United	97	-	14%	18	19%
NIB	104	4	15%	20	19%
Total	675	51	100%	125	

Approximately, 19% of the branches of Commercial banks Islamic windows in Addis Ababa city have taken as a sample. The largest number of observations is from CBE and the lowest from Abay Bank. Then, the branch' managers of these branches was taken as a sample. Furthermore, because of IFB division/department employees are manageable in numbers, all the staffs of Interest free banking department has been taken as a respondent.

Since this study is descriptive in nature, a sample survey of account holders in Interest free windows of Commercial banks is the most appropriate method for data collection. By this method, data collected from the sample clients of seven Interest free banking windows of Commercial banks in the city of Addis Abeba. As the December, 2017, the total number of account holders in IFB would be around 188,000 as, it were taken from their respective banks. The sample size of IFB account holder customers determined in accordance with Fischer (1998) method of sample size determination. The sample size was calculated based on the available IFB

windows' customer population proportion for the study period. The formula for calculating the minimum sample size is

$$n = \frac{Z^2 * P * Q}{D^2}$$

Where n is sample size, p is proportion of variable of interest in the population, z is standard error associated with chosen level of confidence, q is 1- p and d is the precision. The sample size of IFB account holder customers is determined in accordance with the following assumptions: proportion (p) equals to 50%, this is the safest possible assumption, the confidence level of 95% which corresponds to z -value of 1.96 and an error or precision (d) of 5%.

$$n = \frac{1.96^2 * 0.5 * 0.5}{0.05^2} = 384$$

Therefore, 384 would be sufficient to reach the required number or a saturation point according to Fischer (1998). Although the sample size is small in comparison to the actual population, the sample size is adequate for the study. As Roscoe (1975) indicated a rule of thumb for determining sample size is that if the sample is larger than 30 and less than 500 it is therefore appropriate for most research. Since the number of IFB customers' in each bank is not the same, Once the size of sample determine, the number of customers were chosen from each bank is proportionate to the size IFB customers of particular bank, relative to the overall population size. Number of customers in each bank= Proportion of customers size to sample of branch selected * number of sample of branch selected. Proportion of customers size to sample of branch selected is 384/125=3.07 which mean on average 3 customers will be selected per branch. So that, Number of customers in each bank= 3 * number of samples of branch selected.

Table 3.3: Sample size customers from each bank

Sub group	Brach per Bank	Number of customers per Branch
CBE	40	123
CBO	11	34
OIB	13	40
WEGAGEN	14	43
ABAY	9	28
United	18	55
NIB	20	61
Total	125	384.00

Due the fact that no reliable list of names of the IFB window clients was available, convenient sampling was used. Convenient sampling is one of the most commonly used methods of selecting a sample. Questionnaire was given to those customer come into branch premises selected branches and showed their willingness to participate. In general, for the purpose of this study pooled sample comprises 7 IFB windows conventional banks which were established and fully functional before October 31, 2017, 125 branches of these conventional banks and their branch managers and 384 IFB account holder customers in Addis Abeba city using multistage sampling techniques.

3.5 Method of Data Collection

For the purposes of this study, and in view of the fact that the study descriptive in nature both quantitative and qualitative data were collected using primary and secondary sources. Therefore in this study the primary data collected through semi structured interviews and questionnaire items through the adaptation and modification of instruments from review of earlier literature in the area of IFB to ensure that all the relevant issues for this research are covered in the list of

questions; Whereas the secondary data collected by extracting relevant and supportive data and information from the secondary data sources

3.6 Data Analysis Method

The collected data sorted and screened for any errors and then tallied to prepare tables for making analysis. Besides, the study attempted to analyses the various practices and challenges that evolve around challenges of Interest free banking in Ethiopia. The primary data analyzed using the applicable statistical tools after all the necessary primary and secondary data gathered and edited for any errors as well as omissions. The data presented in a useful and organized manner suitable for analysis. The data collected using the questionnaire coded and analyzed using Statistical Package for Social Sciences (SPSS), a computer aided programme. Descriptive statistics mainly of percentiles of the distributions of participant's response was used with the help of SPSS. The results showed using tabular and other forms of presentation in order to convey the intended meaning and be convenient for interpreting the findings of the research. Moreover, a percentage analysis was used for background information and analyzing items that measure the challenges facing Interest free banking in Ethiopia. While mean used to check for central location and mean scores. Qualitative data that obtained from the open-ended questionnaire and interview presented using narrative analysis. Since the study adopted a mixed method choice, the researcher attempted to triangulate findings from customers, and bankers, in order to reach stronger conclusions.

CHAPTER 4

DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presents the results of the study on the practices and challenges of Interest free banking with in commercial banks in Ethiopia. In particular, the aim of this chapter is to empirically analyse data gathered from the distributed questionnaire, interviews conducted and secondary sources about the status, benefits, awareness, shariah compliance and challenges of Interest free banking in Ethiopia. The secondary data was taken from audited financial statement of the respective banks. Furthermore, primary data was collected from the staffs and IFB customers of the banks through distributing questionnaires and forwarding interview questions to the respective department/division managers of the banks. Analysis was made by tabular representation of means, frequencies, trend analysis and narrative analysis of qualitative data.

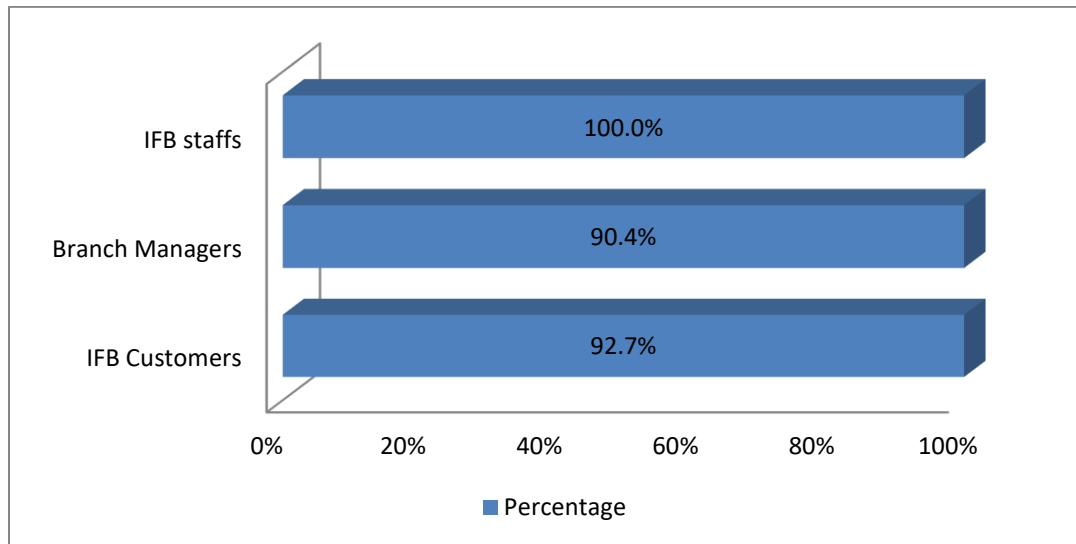
The chapter comprises five sections. Section 4.2 discusses the response rate, demographic details by reflecting on the respondents' profiles and the reliability test of the study. The researcher discusses current status of Interest free banking deposits and Investments within commercial banks in Ethiopia in section 4.3. Section 4.4 to 4.7 provides the empirical results for benefits, awareness, shariah compliance (i.e. segregation of fund, sharia advisory and management commitment) and challenges of IFB. The final section 4.8 provides brief results of interviews.

4.2 Response Rate, Respondents' Characteristics and Reliability test

4.2.1 Response Rate

In this study, the researcher through the branches handed out 384 and 176 questionnaires to the selected bank's IFB customers, branch managers and IFB staffs respectively. Out of the 384 questionnaires distributed to the Customers of IFB 357 have been returned, which yielded a response rate of 92.7%. On the other hand, of the 125 questionnaires distributed to branch managers, 113 were returned and all the 51 questionnaires distributed to IFB staffs have been completed and returned. These indicate a response rate of 90.4% for branch managers' and 100% for the IFB staffs of the banks. This was considered adequate for data analysis because of the nature of respondents' busy schedule.

Figure 4.1 Response Rate



Source: Own Computation from Primary Data Source, 2018

4.2.2 Demographic Characteristics of Respondents

The demographic features and individual characteristics of the respondents play a significant role in the analysis of the survey questionnaire. It is recommended that prior to the actual analysis of the survey the detailed description of the respondents' characteristics could give a better presentation of the collected data. Data collected was processed and analyzed using Statistical Package for Social Sciences (SPSS) version 20. This was done using both descriptive statistics. Descriptive statistics (percentages, frequencies, and means) is related with the methods of organizing, summarizing, presenting data and to describe the characteristics of the sample in an informative and convenient way. In the following sections a detailed description of the demographic features and characteristics of the respondents has been given.

4.2.2.1 Bankers Profile

Table 4.1 shows the general background of the bankers. The first part of the questionnaire gathered such information from respondents, including gender, age, educational qualification and experience of work. It also dealt with the current position of respondent within the bank. Splitting the sample on the basis of gender revealed that 75.6% were male, whereas 24.4% were female participants.

The knowledge of different categories of age is important as it provides researcher with indication of length of education and experience of participants. From the descriptive result, majority of the respondents fall within the age group 28 – 37 years (59.8%) next is 37 – 47 years representing 22%. Also, the respondents that above 47 years are 3 (1.8%) while those that are less than 27 years are 27 (16.5%). The level and type of education for bank employees are another important factor should be consider. The researcher asked respondents to indicate their level of education and their response was as indicated in table 4.1, a good number of them holding a bachelor degree were 106 representing 64.6% while the table also reveals that respondents possessed a postgraduate degree were 35.4%.

The third question dealt with the level of working experience in banking. The majority of response (63.4%) is concentrated in the second and fourth categories (from 2 to 4 and from more than 8 years). Only a quarter of respondents (24.4%), had 5-7 years of banking experience. It reveals from the Table 4.1 that with a small number of new workers (12.2 %), had been working at most 1 year with the current banks. The fourth part of the table dealt with the position of respondents' within the bank. More than two-thirds (68.9%) of the respondents are branch managers. The percentage of IFB staff members who participated in this study was 31.1% respondents. The IFB staff members participated more in the survey as there were 13 IFB Officer, 12 IFB Finance and Investment officer, 7 IFB Accounts and operation officers, 6 Marketing officers and 4 IFB CRM.

Table 4.1: Characteristics of Sample bankers

		Frequency	Percent
Gender	Male	124	75.6
	Female	40	100.0
	Total	164	
Age	18-27	27	16.5
	28-37	98	76.2
	37-47	36	98.2
	47 and above	3	100.0
	Total	164	
Education	First Degree	106	64.6
	Masters	58	100.0
	Total	164	
Experience	<1 Year	20	12.2
	2-4 Years	50	42.7
	5-7 Years	40	67.1
	8>Years	54	100.0
	Total	164	
Position of the respondents'	Branch Manager	113	68.9
	IFB Loan officer	1	69.5
	IFB Accounts and operation officer	7	73.8
	IFB CRM	4	76.2
	IFB Finance and Investment officer	12	83.5
	IFB Loan officer	2	84.8
	IFB Officer	13	92.7
	IFB Research and development	3	94.5
	Internal Auditor	3	96.3
	Marketing officer	6	100.0
	Total	164	

Source: Own computation from primary data source, March 2018

Generally, the above data imply that both branch managers and IFB staff members' who have participated in the study, were appropriate for the study since they had worked for the banks long enough for them to be well aware of practices and Challenges of Interest fee banking service offered by their bank and other commercial banks under study.

4.2.2.2 Customers Profile

Table 4.2: Characteristics of Sample Customers

		Frequency	Percent
Gender	Male	235	65.8
	Female	122	34.2
	Total	357	100.0
Religion	Muslim	357	100.0
	Non-Muslim		
	Total	357	
Banking before IFB	Interest bearing current or/and saving account	116	32.5
	Non-interest bearing current or/and saving account	95	26.6
	I was not a bank customer because of interest	121	33.9
	I had not use bank service due to some other reason	25	7.0
	Total	357	100.0
Years affiliation with the Islamic window	Less than a 1 Year	105	29.4
	1-2 years	195	54.6
	2-5 Years	57	15.9
	Total	357	100.0
Types of IFB account associated with	Saving	189	52.9
	Current	142	39.8
	Investment	26	7.3
	Total	357	100.0

Source: Own computation from primary data source, March 2018

The above table 4.2 shows in the sample, majority (65.8%) of the account holders were male while 34.2% of the account holders were female. This implies that majority of the account holders in the seven commercial banks Interest free banking windows were predominantly male than they were predominantly female. This indicates that majority of the study respondents were male. The table 4.2 shows the faith of the respondents and reveals the fact that 100 percent of the account holders belong to Muslim faith. From a statistical point of view it is a Muslim dominant sample i.e. the sample members belong to Muslim faith and the presence of non-Muslim respondents is nil. This reveals that the awareness among non-Muslim about Interest free banking products and services are less.

It was important to describe the customers banking history before using IFB, where the respondents held their accounts and what type of interest free banking services they utilised.

According to Table 4.2, 32.5% of the respondents revealed that they had commercial bank Interest bearing current or/and saving accounts and 95 out of 357 that means 26.6 percent had Non-interest bearing commercial current or/and saving account only accounts. More surprisingly the table reveals that there are a considerable number of people who were not a bank customer because of interest which is 33.9% of the total sample size. The remaining 7% of the respondents were did not use banking service due to some other reason

It also was important to describe the respondents years of affiliation with commercial banks Interest free banking window and when they held their accounts they currently utilised. The table above also shows 54.6 % of the respondents have been utilised Interest free banking and interest free banking products, 16% of the respondents have been utilised IFB banking services between 2-5 years and another 29.4 percent have relation with commercial Interest free window for less than a year.

The table 4.2 shows the headcount and percentage of those people who participated in the survey and they have different types of accounts. Majority of the respondents have a saving account with the highest percentage of 52.9% followed by current account with a percentage of 39.8%.A relatively small segment of the IFB account holder is operating Investment accounts, in the survey only 7% of the total sample size. Therefore people have started using investment accounts along with saving and current accounts but still not in a significant number.

4.2.3 Reliability Test Statistics

Reliability is the extent to which a measurement gives results that are consistent and fundamentally concerned with issues of consistency of measures (Bryman and Bell, 2007).As a check for internal practices and challenges of Interest free banking. The Cronbah's Alpha statistic varies between 1 (an indication of perfect internal reliability) and 0 (an indication of no internal reliability) (Pallant, 2007).Using SPSS software, result of show that Cronbah's Alpha coefficient is 0.831, 0.84, and 0.732 for the three items examined from customers respectively. While, the computed Cronbah's alphas of the staffs responses are in the range of between 0.738 and 93 per cent. This indicates considerable internal consistency of the responses. The table below shows the reliability statistics as computed by the SPSS software.

Table 4.3: Reliability of Statistics (Test): Customers Item

Item	Cronbach's Alpha	No. of Items
Customers understanding about interest free banking	0.831	5
Customers knowledge about Interest free banking products and services	0.784	10
Customers' attitude towards Islamic windows and interest-free banking services	0.732	7

Source: Output of SPSS, March 2018

Table 4.4: Reliability of Statistics (Test): Staffs items

Item	Cronbach's Alpha	No. of Items
Benefits of practicing interest free banking	0.93	12
Knowledge of bankers towards the interest free banking products on offer in Ethiopia	0.831	9
Complete Segregation of Funds	0.813	8
Sharia Supervisory Board	0.796	6
Managerial Commitment	0.738	7
Challenges of practicing interest free banking	0.874	17

Source: Output of SPSS, March 2018

4.3 Status of Interest free banking in Ethiopia

The financial sector of Ethiopia is dominated by the banking sector. At present, there are 17 commercial banks of which one bank is government bank (CBE) and the remaining are private banks. Interest free banking service in Ethiopia started by two banks in 2013. As on 7th June 2017, seven commercial banks are offering Interest free banking products and services through setting up of Islamic window. This section discusses the status of interest free banking in terms of deposit raised by Islamic windows and their composition as well as the investment and financing activities of interest free banking.

4.3.1 Deposit Products and Amount of Interest free banking in Ethiopia

4.3.1.1 Share and Structure of deposits of Interest free Banking windows

Customers' deposits are the foundation of a bank's activity and the source of finance and its profitability. Table 4.5 outlines the development and growth of Interest free deposits in the 7 Interest free banking windows of the commercial banks that offer Interest free products in Ethiopia. Total deposits of the Interest free banking windows of the commercial banks were stood Birr 9,530,962,880 at the end of June 2017 which accounts 2.17 percent share of the sample banks total deposit. Among the sampled banks, Oromia International bank total deposit (15.13%) accounted by Interest free deposit, followed by Abay bank (7.32%), cooperative bank of Oromia (3.35%), United bank(2.1%), Nib International bank(1.9%),Commercial bank of Ethiopia(1.67%) and Wegagen bank(1.1%). As can be seen from table 4.4 total deposits with Islamic banking windows have grown at a CAGR of 199.72 % between 2013 and 2017.It shows how important Interest free banking growth is in terms of total deposit.

There two possible reasons for such growth. Firstly, before commercial banks started to offer Interest free banking products and services there were a lot of immobilized funds due to the fact that many Muslim clients do not want to involve in any interest dealings. Even those who use the service, some of them donate any interest received to charitable causes, which is regarded as one way of purifying the receipts. In the absence of any other alternative, some were keeping their savings in private lockers or any safe place at their home. While some of commercial banks started offering Interest free products, these people started dealing with these windows. As a matter of fact one of the biggest achievements of Interest free banking in Ethiopia is to bring this huge amount of fund into the banking sector. Secondly, it is now about five years since the first Islamic window established by commercial banks in Ethiopia. During this period we have witnessed a rapid growth as evident by the number of commercial banks started offering Islamic products is increased. The number of commercial banks offering interest free banking products was seven at June 2017. Therefore, some of the Muslim clients had been the customers of banks divert their deposit to commercial Interest free banking windows.

4.5 Total deposits and Percentage growth in Interest free banking deposits

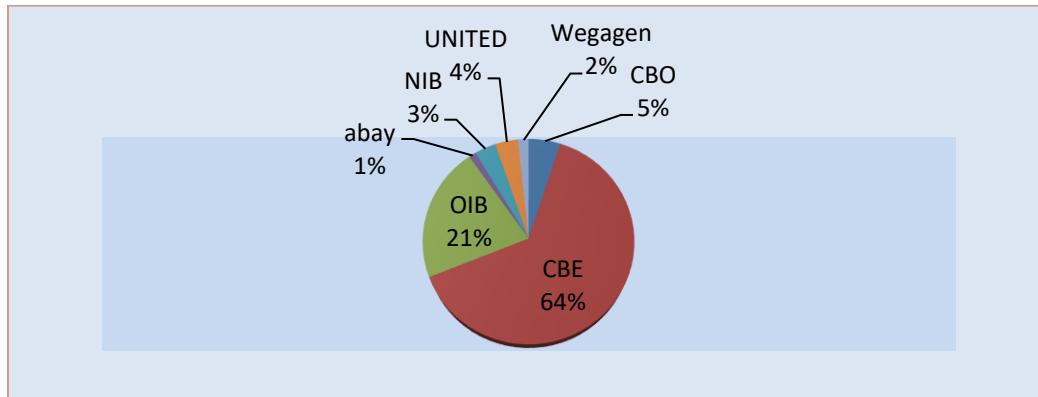
Banks	2013	2014	2015	2016	2017
OIB	-	174,969,759	719,918,877	1,111,929,240	2,030,081,603
			311%	54%	83%
Wegagen	-	-	-	11,520,925	155,831,017
					1253%
CBO	-	-	-	80,728,801	478,493,799
	-	-	-	-	493%
CBE	39,401,818	491,399,184	2,147,152,880	3,171,799,839	6,090,617,940
		1147%	337%	48%	92%
NIB	-	-	-	55,950,300	322,294,300
	-	-	-	-	476%
United	-	1,088,290	93,725,144	219,817,683	346,874,952
			8512%	133%	58%
Abay	-	-	-	89,000,000	106,769,269
	-	-	-	-	20%
Total	39,401,818	667,457,233	2,960,796,901	4,740,746,788	9,530,962,880

Source: own computation from secondary data June 2017

4.3.1.2 Share of deposits of all Interest free banking windows

According to the available information of the sampled commercial banks, the total Shariah-based deposit of 7 commercial banks Islamic windows stood at Birr 9,530,962,880 as of June 2017. The share of total deposits of Islamic windows accounted for 2.17% among all commercial banks that offer Interest free banking during the period under study. As observed in the below chart, Commercial Bank of Ethiopia (CBE) captured the largest share of deposits (64%) among all the Islamic windows commercial banks of Ethiopia. It is followed by Oromia International bank (21%), Cooperative bank of Oromia (5%), United bank (4%), Nib international bank (3%), Wegagen bank (2%) and Abay bank (1%). The dominance of CBE and OIB due to the fact that these banks were the first banks started to offer interest free banking products. Moreover, CBE has the branches across the country; it is currently the bank with the largest number of branches. This strong network across the country enables the banks to reach the public at large from the prominent business man in the main business centers to the farmers in the remotest places.

Figure 4.2: Share of Deposits of All Islamic windows (Amount outstanding as of June 2017)



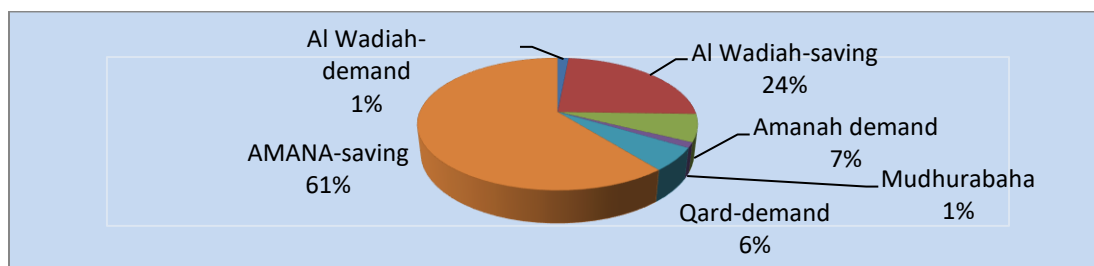
Source: own computation from secondary data June 2017

4.3.1.3 Types of deposits held by Interest free banking windows

An Interest free banks normally has three types of deposit which are comparable with commercial banks account except the term associated and their shariah compliance nature .These are current account deposits, saving account deposit and investment account deposits. The tem used by each bank may be varies depends on how the bank wants to market its product and services. From the below figure 4.3, it can be seen that Amanah saving and Al-Wadiah saving captured a major portion of the Interest free banking deposits, contributing 61% and 24% from the total Interest free banking deposits. These are similar with commercial saving account except the bank is not paid any interest.

Like commercial banks account most of the customers of Islamic window kept their money at the bank for safety purpose. Amanah, Qard, and Al-Wadiah the current account version of Interest free banking contribute 7%, 6% and 1% respectively. Restricted Mudaraba investment account constitutes only 1 % of the Interest free deposit held by the commercial banks. It could be either mudaraba saving or fixed deposit, in which the bank and depositor share the profit and loss which result from the investment activity.

Figure 4.3: Mode-wise deposit Composition of All Interest free banking windows of commercial banks



Source: own computation from secondary data June 2017

4.3.2 Total Financing of Interest free banking windows

Growth in total financing naturally depends on the growth in deposits. This is a very important variable because the overall profitability of the banks depends on this. Total amount of financing in commercial Interest free banking window reached at Birr 1,422,990,151 as of June 2017. The below table 4.6, shows CAGR of 167.04% from 2013, which is from birr 27,980,081 to 1,422,990,151 in 2017, illustrating how important Interest free banking growth is in terms of total financing. From the table shows we can see that Oromia International bank attained the highest share in financing which was 71.8% in 2017. The share of financing made by other windows included commercial bank of Ethiopia (20.77%), United Bank (6.2%), and Cooperative bank of Oromia (1.23%). All of the financing extended to the customers categorized under murabaha mode finance. The remaining Islamic windows have not been extended any type of financing or investment until June 2017.

4.6 Total Financing and growth in Interest free banking

Banks	2013	2014		2015		2016		2017
OIB	-	13,627,969	1780%	256,150,868	92%	491,753,348	108%	1,021,802,609
CBO	-	-	-	-	-	7,693,499	127%	17,433,353
CBE	-	14,352,112	399%	71,687,589	82%	130,760,090	126%	295,545,260
United	-	-	-	-	-	25,450,712	-	88,208,928
Total	-	27,980,081	-	327,838,457	-	630,206,937	-	1,422,990,151

Source: own computation from secondary data June 2017

4.4. Benefits of practicing Interest Free Banking for commercial banks

An Interest free banking by commercial banks can be a department or division set –up by the bank which offer shariah compliant products and services to customers who prefer sharia base finance over conventional. Most of Islamic windows established by commercial banks for two key reasons; to keep the existing customers who are opting to switch to Interest free mode of finance and to attract new customers from existing banks. However, commercial banks also incurred substantial amount of cost to set up and operate interest free banking business. These include opportunity cost using existing infrastructure, purchasing and installing a separate system which is incompatible with the conventional system, hiring specialists including managers and shariah advisors and other promotional and operational costs. In contrary Interest free banking by commercial banks is purely on commercial objectives and Priority of the management and board of directors of the commercial banks is to maximize profit. So that the incremental benefits those banks have been got should be determine. To determine the benefits that achieved by banks through start to providing shariah compliant products and services, the bank staffs of were asked to rate the below items be on a five point likert scale where one represent strongly disagree and five represent influence to a great strongly agree.

Table 4.7: Bankers response about Benefits of practicing interest free banking

Benefits of practicing Interest Free Banking	Strongly disagree	Disagree	Neutral	Agree	Strongly disagree	Mean
Interest free banking serve as an alternative banking system to existing conventional banking service		7.3%	21.3%	42.7%	28.7%	4.04
Interest free banking helps to keep existing customers of banks who are opting to switch to other banks	8.5%	4.9%	9.8%	28.0%	48.8%	3.93
Interest free banking helps banks to attract new customers from existing banks	12.2%	0.6%	12.8%	49.4%	25.0%	3.80
Interest free banking improve competitiveness of banks	6.1%	2.4%	15.2%	53.7%	22.6%	3.96
Number of customers increased when the bank starts to provide Interest free banking products	12.8%		1.2%	65.2%	20.7%	3.82
Interest free banking increase customer base	10.4%	3.0%	9.1%	53.0%	24.5%	3.83
Interest free banking enhance the bank’s brand image	7.9%	7.3%	11.0%	44.5%	29.3%	3.85
Deposits increased with introduction of Interest free banking	8.6%	0.6%	1.8%	51.2%	37.8%	4.09

Interest free banking products are meeting the financial needs of Muslims customers	7.9%	15.9%	22.6%	38.4%	15.2%	3.37
Interest free banking increase comfort levels of Muslim customers	4.9%	17.1%	13.4%	52.4%	12.2%	3.47
Interest free banking enable banks provide variety of products for customers	18.3%	7.3%	3.1%	51.2%	20.1%	3.48
Interest free banking able to offer viable and competitive financial products	10.4%	22.5%	10.4%	35.4%	21.3%	3.35

Source: Own Computation from Primary Data Source, March 2018

The table 4.7 shows that the vast majority of the people have agreement with the statement that “Interest free banking serve as an alternative banking system to existing commercial banking service”. Among 164 respondents, only 7.3% of the respondents said that disagreed to the statement and another 21.3 of the sample respondents had an impartial view. Another 42.7% respondents said that they agreed to the statement but those who strongly agreed to the statement were counted to 28.7%. The survey results show that almost 71.4% of the people agreed that Interest free banking serve as an alternative banking system to existing conventional banking service. The reported mean for this measure was 4.04. This indicates a degree of agreement about the statement. The director of Interest free banking of Oromia international bank argue that for past five years many Muslims who had been unbanked as well as previously using commercial banks interest based banking service due to non-existence of Interest free banks and interest free banking service stated to using Interest free banking services as alternative to conventional part. It is not difficult to suggest that the number of people using Interest free banking products will increase in the coming years as awareness about the Interest free banking is increasing.

It has already been mentioned that that most of Islamic windows of commercial banks established not to convert the whole bank into an Islamic institution rather to keep existing customers of our bank who are opting to switch to other banks and/or to attract new customers from existing banks. Keeping in mind this concept, the respondents were questioned about their views regarding the statement “Interest free banking helps to keep existing customers of the bank who are opting to switch to other banks” and “Interest free banking helps our bank to attract new customers from existing banks”. According to the survey results, 76.8% and 74.4% respondents said that they agreed to the statements and they think that the Interest free banking helps banks to keep existing customers as well as to attract new customers respectively. The reported means for

the above two items were 3.93 and 3.8. This finding suggests a general agreement to those statements. This suggests that in the current highly competitive industry such as banking industry having a banking service which helps the banks to keep their customers who are opting from switch to other banks and to attract new customer from other banking through offering a competitive product which satisfy the customer needs is a powerful tool to be competitive and to achieve a greater market share. That is why 10 out of 15 commercial banks which include three banks in pipeline have started to offer Interest free banking products.

The table 4.7 shows the responses of the respondents regarding the statements “Number of customers increased when our starts to provide Interest free banking products” and “Interest free banking increase our customer base”. These statements are a supplement of the previous two statements. It is related to whether or not the Interest free banking service of commercial banks will help the bank to increase its number of customer and customer base. The survey result shows that, 85.7% and 77.5% of the respondents agree or strongly agreed to the statements that Islamic windows increased customers of commercial banks as well as their customer base when starts to offer interest free banking service respectively. The reported means (3.82 and 3.83 respectively) indicate that the most of the branch managers and officers of staffs of interest free banking department agree that the number of their customer increased when the bank starts to offer Interest free banking product and services. The customers may be previous unbanked or under banker due to the presence of interest in commercial banking transaction or using commercial banking as mere alternative for commercial transaction. This result is corroborated by annual reports of the bank which shows significant increment in customer size since they started to offer Interest free banking products.

The above table also shows the responses of the respondents about the statement is aimed at collecting the information from the branch managers and staffs of IFB concerning their perception about whether Interest free banking improve competitiveness of the bank and enhance the bank’s brand image. In the sample of 164, 76.3% respondents said that Interest free banking improve competitiveness of the bank. Whereas, 73.8% of the respondents agree to the statement that Interest free banking enhance bank’s brand image. The reported mean of the above two items were 3.96 and 3.85 respectively. This indicated that some commercial banks in Ethiopia banking industry have got a good reputation with Interest free banking products and contribute

significant portion from total revenue. This result is also corroborated by interview conducted by the researcher with Directors of Interest free banking department/division. Most of them agreed that some banks have a good brand in their interest free banks as such part. Furthermore, according to Table 4.4 89 per cent of the bankers agree or strongly agreed that deposits of their bank increased with introduction of Interest free banking products and services. Whereas, 3 (1.8 %) had an impartial view and only 15 (9.2%) people did not agree to the statement. The reported mean of the above item was 4.09. This indicates the deposit of commercial banks currently offering interest free banking products increased every year since the bank starts to offer interest free banking service. This response corroborated with the annual reports of these banks which indicates significant increment of interest free deposit every as compared with interest bearing deposit of banks. Even significant portion of the total deposit some banks constituted by Interest free deposits.

The table 4.7 shows the responses of the respondents about the statement that the Interest free banking products are meeting the financial needs of Muslims customers. Among 53.6% of the participants said that the sampled banks meet the financial need of Muslim clients through Interest free banking .There were 21.8% of the people who said that conventional have not meet the financial need of the bank using Interest free banking products and another 22.6 % of respondents did not show any response to this statement. Moreover, 64.6% of agree or strongly agree that commercial Interest free banking increase comfort levels of Muslim customers. Whereas, 13.4% had an impartial view and 22 % did not agree to the statement. Furthermore, 71.3% of the respondents agree or strongly agree to the statement that Interest free banking enable commercial banks provide variety of products for customer while 21.6% of the respondents did not agree to the statement and 3.1 % had a neutral view. Lastly, the statement was included in the questionnaire to ask the respondents about their views concerning Interest free banking able to offer viable and competitive financial products. In the above table we can see that 56.7% agreed to the statement that commercial banks able to offer viable and competitive financial products. There were only 10.4% respondents who disagreed to the statement. The remaining 32.9% showed no response to the statement and remained impartial.

The overall mean reported for the last four items was ranged between 3.35 and 3.48.This indicates a high degree of uncertainty about statements. Although the mean is near to neutral, the

fact that it tilts towards their agreement largely suggests that even though most of respondents believed that interest free banking services serve as alternative system banking but they are not sure whether sampled banks have meet the financial needs as well as increase comfort levels of Muslim customers. The respondents also uncertain about commercial banks interest free window able the bank to offer variety of product that are viable and competitive to conventional banking products.

4.5 The level of Awareness of Bankers and Customers about Interest free banking and Interest free banking products

The level of understanding, awareness, and knowledge of the public in general and bankers and customers in particular are the cornerstones for the development of any banking service. This is more so for a banking service like Interest free banking, which is still nascent in Ethiopia. However, many managers of commercial banks and staffs of interest free banking department/division who are responsible for operating and marketing Interest free banking products are not very well trained in Interest free modes of finance. The study sought to assess the degree of respondents' awareness and whether they understood the nature of interest free products. The greater awareness about the product and service offered by Islamic windows of commercial banks will enhance the continued growth of this type banking service.

Furthermore, the basic awareness of the customers and their essential knowledge about Interest free banking were also addressed. The respondents of the survey questionnaires were specifically asked their level of understanding about Shari'ah principles of interest free banking as well as detailed awareness of Shari'ah compliant Interest free products, i.e. to what extent the customers of Interest free window is aware various types of bank accounts as current, saving, and investment based on these Shari'ah principles as well as Murabaha, Ijara and profit and loss Financing modes accounts.

4.5.1 Awareness of Bankers

Table 4.8: Bankers awareness about interest free banking products and services

Items	Fully Aware		Little Aware		Fully unaware	
	Freq	%	Freq	%	Freq	%
Murabaha (mark-up principle)	113	68.9%	48	29.3%	3	1.8%
Musharaka (joint venture)	63	38.4%	54	32.9%	47	28.7%
Mudharabah (trust financing)	68	41.5%	81	49.4%	15	9.1%
Ijarah (leasing)	65	39.6%	80	48.8%	19	11.6%
Salam (purchase order) financing	60	36.6%	64	39.0%	40	24.4%
Istisnaa (pre-paid purchase)	69	42.1%	76	46.3%	19	11.6%
Wadi'ah/Amana (safe-keeping contracts for current and saving deposit)	108	65.9%	45	27.4%	11	6.7%
Wakalah (safe-keeping contracts for agency contracts)	64	39.0%	73	44.5%	27	16.5%
Quard Hassan	72	43.9%	67	40.9%	25	15.2%

Source: Own Computation from Primary Data Source, March 2018

The above table summarizes branch managers and staffs of Interest free banking awareness about Interest free banking products currently offered in their bank premises. First, a high proportion of the respondents are aware of Wadi'ah/Amana and murabaha mode of deposit and finance currently provided by most of Islamic windows of commercial banks in Ethiopia with a level of approximately 66 % and 69 % respectively. However, a significant number of the respondents mention that they are little aware or not aware of the specific Islamic terms of Mudarabah (58.5 per cent) and Musharakah (61.6 per cent). In addition, more than half of the respondents are little aware or unaware of the trade based and lease based mode of finance on the interest free principles of Salam (63.4%), Istisnaa (57.4%) and Ijarah (60.4%) respectively. Furthermore, most respondents are unaware regarding other Interest free financing methods such as Wakalah (safe-keeping contracts for agency contracts) and Quard Hassan (benevolent loan). This result could be asserted by the type of Interest free products and services the sample banks currently offers and how much they know about the nature of each product and services. As per interview result, most of commercial Islamic windows in Ethiopia offered Wadi'ah/Amana deposit account and murabaha mode of trade finance event though the list of products the banks advertise in media or in their website includes other modes of finance unless they tries to accommodate every customer finance and investment requests with a single product category of murabaha. These implies that majority of the branch managers and staffs of Interest free banking

department/division lack of awareness of Interest free banking products and have little awareness about the operations of Interest free banking that their entire dependence is based on such products which contain a major and a prominent element of Investment, trade and leasing mode of finance.

4.5.2 Customers’ awareness and attitude towards Interest free banking and products

4.5.2.1 Customers’ awareness about interest free banking

In this part of the survey, the questions of the survey were designed to gather the information from the customers about awareness of the customers and their essential knowledge about interest free banking were addressed. Specifically focused on the detailed awareness customers about interest free banking principles and Shari’ah based products and services in the market, i.e. to what extent the customers of Islamic window aware Al-Wadiah/Amana, Quard, Murabaha, Musharaka, Mudharabah, Ijara and various types of bank accounts as current, saving, and investment based on Shari’ah principles. One of the most significant parts of the survey questionnaire is a question that contains a number of statements about practices and Challenges of Interest free banking in Ethiopia.

Table 4.9: Customers awareness about interest free banking and its’ principles

Items	Strongly disagree	Disagree	Neutral	Agree	Strongly disagree	Mean
I understand the key concepts of Interest free banking	21.6%	28.9%	28.3%	14.3%	7.0%	2.5630
I understand the sharia principles of Interest free banking	13.2%	37.8%	19.0%	18.2%	11.8%	2.7759
I understand the technical differences and mechanisms of Interest free and Interest based banking	19.6%	28.0%	23.8%	14.6%	14.0%	2.7535
I know how my deposits and savings are invested by the banks	22.7%	34.2%	21.3%	14.5%	7.3%	2.4958
I understand the benefit and types of interest-free banking services in Ethiopia	20.4%	30.8%	12.9%	21.6%	14.3%	2.7843

Source: Own Computation from Primary Data Source, March 2018

The table 4.9 shows the responses of the respondents about the statement that customers of Interest free bank in Ethiopia understand the key concepts of Interest free banking. Among 357 respondents, 50.5% of the respondents disagree or strongly disagreed to the statement that customers of Interest free banking understood the key concept of Interest free banking that govern the operation of sharia based banking service. There were only 21.3% of the respondents

who said that they understand the key concepts of Interest free banking and 28.3% of the respondents did not show any response to this statement. The reported mean for the above statement was 2.56 which indicate customers lacked proper understanding of the key concepts of interest free banking and as such there is need for awareness creation on this important aspect of Interest free banking. Furthermore, a Statement was included to know whether customer of Interest free banking understood or aware the shariah principles of Interest free banking. There survey there were only 30% %) participants who agreed to the statement and they understand the sharia principles of Interest free banking. Another 19% of respondents had an impartial view. The approximately half of the respondents i.e. 51% of bankers said that they disagreed or strongly disagreed to the statement they understand the sharia principles of Interest free banking. The reported mean of this statement was 2.77 which indicate indicates a high degree of uncertainty about their knowledge their knowledge of sharia principles which govern interest free banking operation.

According to the survey results, 47.6% of respondents said that they disagreed to the Statement and they think that they did not understand the technical differences and mechanisms of Interest free and Interest based banking. There were 28.6 % of the respondents who agreed that they understand the technical differences and mechanisms of Interest free and Interest based banking and another 23.8 % did not show any viewpoint on this issue. The reported mean of the statement was 2.75 which indicate customers of the interest free banking uncertain about whether they real understand the technical differences and mechanisms of Interest free and Interest based banking. Moreover, the above table also shows the responses of the sample respondents about the statement that customers of Interest free banking know how the deposits and savings of the bank customers are invested by the banks. 56.9% of the respondents that they did know how the bank invested customers deposit in the bank. There were 21.9 % of the respondents who said that they know how the bank invested customers deposit in the bank and another 21.3% did not show any response to this statement. The reported mean was 2.49, which suggests a general agreement to that statement. This suggests that customers of commercial banks Islamic window unaware how the bank invested the deposit they save in the bank, this may create misunderstood that commercial bank fund comingled with Interest free deposit. Lastly, customer of interest free banking in Ethiopia in the city of Addis Ababa were asked about their view concerning their understanding about the benefit and types of interest-free banking services in Ethiopia. In the

table we can see that 183 out of 357 which is more than half (51.2%) disagreed to the statement that they are not understood benefit and types of interest-free banking services currently offered by commercial banks in Ethiopia. There were 35.9% respondents who disagreed to the statement. The remaining 12.9% showed no response to the statement and remained impartial. The reported mean for the above statement was 2.78 which indicate customers lacked understanding of benefit and types of interest-free banking services in Ethiopia.

4.5.2.2 Customers awareness about Interest free banking products and services

The table 4.10 summarises the awareness about Interest free banking products and services. It seems that the majority of the respondents showed a good understanding of Al-Wadiah, Quard and Amana savings and current accounts. More particularly, 43.1% of the respondents were aware of current account based on the Quard principle; 54.6% of the respondents were aware of current and saving based on the Amana principle and 58% of respondents were aware of Al-Wadiah savings and current accounts. This clearly indicates that a high proportion of the respondents are aware of Interest free deposit types. However, 80% of the respondents were not aware of Investment deposit (Mudarabah). Trade and lease based product are among the most common products and services offered by Interest free banks including Islamic window of commercial banks. A significant number of the respondents mention that they are not aware of the specific Islamic terms of mudarabah, 37% of all respondents have knowledge about murabaha mode of finance. However, the findings indicate that terms such as Ijarah, Istisna and Salam were not well understood.

More specifically, only 20.7% of customers are knowledgeable about the Ijarah of lease finance, only 16.2% of customers are knowledgeable about the Istisna trade finance and only 12.3% of customers are knowledgeable about the Salam trade finance. Regarding profit and loss sharing account, only 14.5% of the respondents were aware of Mudharaba investment account while only 12.3% of the respondents were aware of Musharaka. This implies that majority of the bank's customers had a poor understanding of profit and loss accounts. Awareness of Interest free banking methods has a positive effect on potential use of Interest free methods of finance. According to the survey, majority of the account holders indicated that they did not well understand Interest free product and services that have been offered or expected to offer in the near future. This shows that there is still a need to create awareness among the general public

including the bank customers about Interest free banking products and services. Greater awareness through advertisement and other media platforms with regard to the products and services offered by Interest free banking windows of commercial banks will cause others who had stayed away from this mode of banking to invest in it and enhance the continued growth of this type of banking service.

Table 4.10: Customers awareness about interest free banking products and services

Items	Fully Aware		Little Aware		Fully unaware	
	Freq	%	Freq	%	Freq	%
Quard	154	43.1%	115	32.2%	88	24.6%
Amana	195	54.6%	102	28.6%	60	16.8%
Wadiah	207	58.0%	120	33.6%	30	8.4%
Mudaraba deposit	34	9.5%	77	21.5%	246	68.9%
Murabaha	132	37.0%	60	16.8%	165	46.2%
Ijarah	74	20.7%	120	33.6%	163	45.7%
Salam	44	12.3%	150	42.0%	163	45.7%
Istisna	58	16.2%	90	25.2%	209	58.5%
Mudarabah investment	52	14.5%	140	39.2%	165	46.2%
Musharakah	44	12.3%	74	20.0%	239	66.9%

Source: Own Computation from Primary Data Source, March 2018

4.5.3 Customers attitude towards Interest free banking products and services

Table 4.11: Customers attitude towards interest free banking and products

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Mean
I do not think that Interest-free banking window of conventional commercial banks is a good way to manage the customers funds.	8.4%	14.3%	21.2%	23.8%	32.2%	3.5714
An interest-free window of commercial bank is a good alternative to conventional banking.	22.1%	22.4%	15.7%	19.3%	20.4%	2.9356
I believe that Interest-free windows of conventional banks are following the Sharia principles of interest-free banking	34.7%	14.3%	19.3%	21.3%	10.4%	2.5826
There is a real interest in an interest free banking in Ethiopia.	7.0%	9.2%	12.9%	35.0%	35.9%	3.8347
I believe that Interest-free banking window is not different from the conventional ones, except for the use of a few Arabic terms to suggest Shariah compliance	24.1%	14.3%	17.9%	20.2%	23.5%	2.9524
I have doubts about Interest-free banking window	14.0%	18.8%	16.8%	32.2%	18.2%	3.2185
The employees' Interest-free windows/departments are not fully aware and competent in the field.	16.5%	11.9%	14.8%	31.1%	25.8%	3.3782

Source: Own Computation from Primary Data Source, March 2018

An Interest free banking window by a conventional bank is another dimension of Islamic banking operations which manage customers' funds from Halal sources. However, many customers concerned about the funds of conventional banks coming from interest based dealings mixed with Islamic window fund. Keeping in mind this, the account holders of Islamic windows were questioned about their views regarding the statement that Interest-free banking window of conventional is a good way to manage the customers' funds. The majority of the customers agree or strongly agreed to the statement, 56 % said that they did not think that Interest-free banking window of commercial banks is a good way to manage the customers' funds. Almost a one fifth of the (21.2%) of respondents remained neutral whereas 22.7% respondents did not agree to the statement. The reported mean of the above statement was 3.57 which indicate agreement among most of the respondents to the statement. This indicates Commercial banks with Islamic window should to work in cooperation to raise awareness among the public how Islamic windows manage the fund raised through Islamic window. Alternative they can adopt other forms of Islamic banking particularly the branch or subsidiary model since the current directive is not allowed to establish an independent full-fledged Islamic bank.

Moreover, the above table also shows the responses of the account holders of the Interest free banking about the statement "An interest-free window of commercial banks is a good alternative to conventional banking." The statement is aimed at collecting the information from the account holders concerning their attitude about does Islamic window of conventional banks serve as a viable alternative to conventional banks for their various financial needs. 39.7% of the respondents said that an interest-free window of commercial is a good alternative to conventional banking. Whereas, 44.5% of the sample respondents did not the statement and 15.7% had a neutral view. The reported mean (2.93) of the statement implies that most of the customers are uncertain about Interest free banking service of the commercial banks serves as a viable and dependable alternative for conventional banking services. Some response of customers from open ended part of the questionnaire told us they use Interest free window of the commercial bank as a last alternative and basically for safety purpose rather than considering it as alternative to do business.

The first and most important requirement for Interest free banks including Islamic window of the conventional commercial banks is to follow the Sharia principles of interest-free banking. Moreover, the customer attitude towards weather Islamic window of the commercial banks

comply with the shariah requirement is very vital to get public acceptance and for its future viability. Accordingly, the respondents were asked question about their view regarding Interest-free windows of commercial banks are following the Sharia principles of interest-free banking. Among respondents, 49% of the respondents did not believed that Interest-free windows of conventional banks follows the Sharia principles of interest-free banking. 31.7 % of the respondents did agree to the statement and 19.3% of the respondents had neutral view. The reported mean was 2.58 which indicate significant number of the respondents believed that the operation of Interest free banking is not in line with the shariah principle.

Furthermore the table 4.11 shows that the vast majority of the customers have agreement with the statement that “There is a real interest in a free banking interest in Ethiopia”. 70% of the sample respondents agree or strongly agreed that there is a real demand for interest free banking products. Whereas, 16.2% of the respondents disagree to the statement and another 12.9% had a neutral view. The reported mean 3.83 which indicate a greater agreement among the respondent about the presence of real interest for interest banking products and service even though they are not sure the current window accommodate their interest.

Moreover, One of the most common statement made by critiques of Islamic window of commercial banks is they are not different from the conventional banking system, except for the use of a few Arabic terms to suggest Shariah compliance, So that, the account holders of the bank were asked about their perception about the above statement. Among sampled respondents, 43.7% of the account holders agree or strongly agree to the statement that it is only a change of name. In contrary 38.4% of the respondents did disagree to the statement and 17.9% had a neutral view. The reported mean of was the above statement was 2.95 which indicates uncertainty about whether Islamic window of commercial banks mere a change of a name or actually differ in their principle and operation from the conventional banking business.

4.6 Shariah requirements for conventional banks

Many commercial banks are increasingly becoming interested in Interest free banking. The most important of these required conditions are: complete segregation of funds; existence of a sharia supervisory board and management that is committed to marketing and promoting Interest free banking. The first and foremost requisite for a true Islamic window is that it is carefully separated from the general side of the conventional bank (Usmani, 2002). Separation is not only a physical partition in a branch between Islamic windows and the conventional section, but also separation in all kinds of activities, functions, recording and reporting. There should be a sharia supervisory board or shariah advisor for any institution which tries to offer sharia compliant products and services. Moreover, the commercial bank's management, which is undertaking such Islamic banking, should be fully convinced of the concept and fully committed and dedicated to it. The following section attempted to discuss the shariah requirements for conventional commercial that operate Interest free banking.

4.6.1 Complete Segregation of Funds

Table 4.12: complete segregation funds

Complete Segregation of Funds	Strongly Disagree	Disagree	Neutral	Agree	Strongly Disagree	Mean
The funds mobilized through Interest free banking is commingled with the funds of the deposits mobilized through conventional branches.	40.2%	14.0%	18.3%	23.2%	4.3%	2.37
The deposits received by the Islamic window is not mixed up with the deposits taken on conventional side	10.4%	6.7%	8.5%	36.0%	38.4%	3.85
The funds sourced through Interest free banking activities are kept separate from the conventional activities of the bank and are only invested in Shariah-compliant investments.	9.8%	10.4%	16.5%	26.8%	36.5%	3.70
Conventional capital is used for Shari'ah compliance	43.9%	11.0%	21.3%	12.2%	11.6%	2.36
The bank maintain firewall between Interest free banking and conventional liabilities	16.5%	7.3%	28.1%	27.4%	20.7%	3.28
Interest free banking of the bank has an effective system in place to separate Islamic assets and funds from conventional ones	17.1%	0.6%	19.5%	43.3%	19.5%	3.47
The bank maintains a separate accounts, books, and records for Interest free banking	14.0%	0.6%	7.9%	39.7%	37.8%	3.86
The bank maintains a separate balance sheet and Interest free banking books	14.0%	6.7%	7.9%	29.3%	42.1%	3.78

Source: Own Computation from Primary Data Source, March 2018

The table 4.12 shows that the vast majority of the respondents have disagree with the statement that “The funds mobilized through Interest free banking is commingled with the funds of the deposits mobilized through conventional branches.” Among 164 respondents, only 27.5 % of the respondents said that they agreed to the statement and another 18.3% respondents had an impartial view. Another 14 % respondents said that they disagreed to the statement but those who strongly disagreed to the statement were counted to be 40.2%. The survey results show that almost 54% of the people disagreed that the funds mobilized through Interest free banking is commingled with conventional funds.

Above table also 4.12 shows the responses of the people regarding the statement “The deposit received by the Islamic window is not mixed up with the deposits taken on conventional side.” This statement is a supplement of the previous statement. It is also related to the objective of the research that how far the operation of conventional banks Shari’ah and meet the shariah requirements for conventional which adopt shariah compliant banking product and services. Almost 75% of the respondents were agree or strongly agreed to the statement. This number (75%) is relatively higher than the percentage of previous item who agreed to the statement (54%), it shows the majority of respondents have the opinion that the fund raised and deposit mobilized through Islamic window is not mixed or commingled with the deposited mobilized through conventional branches.

According to the survey results, 63.3% respondents said that they agreed to the statement and they think that the funds sourced through Interest free banking activities are kept separate from the conventional activities of the bank and are only invested in Shariah-compliant investments. There were only 20.2 % respondents who disagreed to the statement and another 16.5 % did not show any viewpoint on this issue. Moreover, branch managers and IFB staffs were questioned about whether Conventional capital is used for Shari’ah compliance business, 54% of them were disagreed to the statement. Only 32.8 % respondents did agree to the statement and another 21 % remained impartial and did not show any response to the statement. This Indicate that not only Islamic window funds are not used for conventional banking purpose but also conventional banking fund are not used for Shari’ah compliance business.

In order maintain effective segregation of fund between the funds raised through Islamic window and conventional branch, the bank should maintain firewall between Interest free banking and conventional liabilities; a separate account, books, and records for Interest free banking; and a

separate balance sheet and Interest free banking books. According to the above table 48.1% of the respondents were agree or strongly agreed to the statement that conventional banks currently offering Interest free banking maintain firewall between Interest free banking and conventional liabilities. There were only 23.8% who disagreed to the statement and the remaining 19% respondents did not show any response to the statement and remained impartial. The bankers also asked does conventional banks has an effective system in place to separate Islamic assets and funds from conventional ones and 62.8% of them agreed that the bank maintain effective system to separate Islamic asset and fund from conventional part. Furthermore, the vast majority of the respondents have agreement with the statement that “The bank maintains a separate accounts, books, and records for Interest free banking”. The survey results show that almost 78% of the people agreed that the bank maintains a separate accounts, books, and records for Interest free banking operation with in conventional banks. Finally, the respondents were asked whether the bank maintains a separate balance sheet and Interest free banking books.71.4% of them agreed that their bank maintain a separate book including the balance sheet.

From the computation of the researcher, descriptive statistics result showed that the mean score for the complete segregation fund was reported to be 3.66 except the first and fourth item. It is closer to the scale measure of agreement which is 4, and therefore an indication that, although they were uncertain about some questions, they largely agree to the point that the bank maintains effective system, a separate book and record including balance sheet for interest free banking operation.

4.6.2 Sharia Supervisory Board

Table 4.13: Shariah Supervisory Board

Sharia Supervisory Board	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean
The bank establishes a working Shari’ah supervisory board (SSB) and strictly comply with its guidance	40.9%	18.9%	19.5%	12.8%	7.9%	2.280
Shariah board acts as a watchdog while issuing different products	40.9%	20.7%	22.6%	11.6%	4.3%	2.177
Shariah scholars play their role while issuing different products	25.6%	25.0%	24.4%	12.8%	12.2%	2.610
There is no new operation which is undertaken without prior approval from the board.	31.1%	14.0%	29.9%	14.6%	10.4%	2.591

The Shariah Board regularly monitors the functions and operations of the windows (Shariah audit)	17.7%	24.4%	17.7%	20.7%	19.5%	3.000
The Shariah Board practically engaged in meetings with bank's personnel, direct customer interaction, visiting banks various premises to engage and review Interest free banking activities	39.0%	17.7%	19.5%	13.4%	10.4%	2.384

Source: Own Computation from Primary Data Source, March 2018

Table 4.13 shows that 59.8% of the respondents have disagreed or strongly disagree to the statement that conventional banks currently offering Interest free banking service establishes a working Shari'ah supervisory board (SSB) and strictly complies with its guidance with a resulting mean of 2.28. This indicate most but not all conventional banks Islamic window have not yet established their own separate Shari'ah Board that supervised and offered guidance to their operating systems. Above table also 4.13 shows the responses of the people regarding the statement "The Shariah board acts as a watchdog while issuing different products." This statement is a supplement of the previous statement. It is also related to the objective of the research that Interest free banking including conventional banks Islamic window should establish a working shariah board and serve as a watchdog while issuing different products as wells as their activity. Almost 62% of the respondents with a resulting mean of 2.17 disagree to the above statement. According to the survey results, 50.6% of respondents with a resulting mean of 2.61 disagreed to the statement that there is no new operation which is undertaken without prior approval from the board.

Moreover, 75% with a resulting mean of 2.59 disagree with the point that Shariah scholars play their role while issuing different products Shariah scholars play their role. The table also 4.13 shows the responses of the respondents regarding the statement "The Shariah Board regularly monitors the functions and operations of the windows (Shariah audit)". 42.1% of the respondents with reported mean of 3.0 disagreed to the statement and most of Islamic window of conventional banks have not monitored by shariah board or advisor. Contrarily there were 40.2 % of the respondents who agreed to the statement and the remaining 17.7% did not show any response to the statement and they remained impartial. Finally, 56.7% of the respondents disagree or strongly disagree to the point that the Shariah Board practically engaged in meetings with bank's personnel, direct customer interaction, visiting banks various premises to engage and

review Interest free banking activities. Those who remained impartial were 19.5% and only 23.4% agreed to the statement. From the discussion above it is not difficult to say that most of conventional banks in Ethiopia currently offering Interest free banking service does not have sharia supervisory board and did not perform the basic function of monitoring whether the activities and products offered by these window in compliance with shariah principle or not.

4.6.3 Management Commitment

Table 4.14: Management Commitment

Management Commitment	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean
commercial banks lack real commitment to the development of Interest free banking	16.4%	12.8%	12.8%	36.0%	22.0%	3.3415
The bank management shows commitment in marketing and promoting Interest free banking products and services	30.5%	22.5%	17.7%	18.3%	11.0%	2.5671
The management of the bank is committed and dedicated to run its business according to the principles governing Interest free banking	20.1%	25.6%	23.2%	16.5%	14.6%	2.7988
The bank has a proper institutional framework for Interest free banking system rides on the back of commercial Banking system.	21.3%	32.3%	25.6%	12.3%	8.5%	2.5427
The Interest free banking have got the same respect as other businesses within the bank	15.9%	26.2%	25.6%	20.1%	12.2%	2.8659
Interest free banking's are viewed mostly as a support division, rather than an operational division	15.9%	17.7%	16.4%	28.7%	21.3%	3.2195
Managements of the bank fear cannibalization of commercial banking by Interest free banking	26.8%	11.6%	37.2%	17.7%	6.7%	2.6585

Source: Own Computation from Primary Data Source, March 2018

Unless entire management is committed and convinced, the operation and development of Interest free banking business by commercial banks will not be achieved. Both organizational and management commitment are needed to escape irregularities and to gain public trust. Table 4.14 shows that 58.8% of the respondents feel that, Conventional banks lack real commitment to the development of Interest free banking while 29.3 % of the respondents disagree to the statement that commercial bank currently offering interest free banking products lacks real commitment to the development of Interest free banking .However, a total of 12.6% of the respondents are skeptical this idea. The reported mean for this item was 3.34. This indicates a degree of neutrality about the statement. It suggests that they are unsure whether commercial banks committed to develop and promote Interest free banking services or not. The above table also shows the response of the respondents in the survey regarding another statements which is

are also related with the bank management commitment to run its business according to the principles governing Interest free banking and marketing and promoting Interest free banking products and services. In the sample 164, 53.1% of the sample respondents disagreed to the statement and it means in their view management of commercial banks lacks commitment in marketing and promoting Interest free banking products and services. The response of regarding the statement that the management of commercial bank are committed and dedicated to run its business according to the principles governing Interest free banking Statement in the questionnaire, 45.7% of the respondents disagree or strongly disagree to the statement. There were 31.1% of the respondents who said that they agree or strongly agree to the statement whereas 23.2% did not show any response and remained neutral. The reported mean value for the above two item were 2.56 and 2.79 respectively .This indicates a high degree of uncertainty about the management of conventional banks commitment.

Table 4.14 shows that 53.6% of the respondents with reported mean of 2.54 disagree to the statement that commercial banks currently offering interest free banking products and services has a proper institutional framework for Interest free banking system rides on the back of conventional Banking system. Moreover 42.1% of the sample respondents disagree or strongly disagree to the item which state that Interest free banking have got the same respect as other businesses within the bank. The reported mean of this item 2.86 is closer to the scale measure of neutrality which is 3, therefore an indication that, they have doubt about Interest free banking have got the same respect as other businesses within the bank. Furthermore, half of (50%) of the respondents with reported mean of 3.29 agreed that the Interest free banking's by commercial banks are viewed mostly as a support division, rather than an operational division. Contrarily there were 33.6 % of the respondents who agreed to the statement and the remaining 16.5% did not show any response to the statement and they remained impartial. Finally, 38.4% of sample respondents disagree with the statement that managements of the bank fear cannibalization of conventional banking by Interest free banking. Whereas, 34.4% of them did agree to the statement and another 37.2 % remained neutral.

The overall mean reported about management commitment towards Interest free banking by conventional banks is given as 2.85. This indicates a high degree of uncertainty about whether conventional banks in Ethiopia really committed to promote, run its according to the principles governing Interest free banking, to establish proper institutional framework and give proper

respect as well as support. Although the mean is near to neutral, the fact that it tilts towards their disagreement largely suggests that most of commercial banks Interest free banking window lacks commitment while it success depends on their commitment and devotion for the principle in which Interest free banking works.

4.7 Challenges of Interest free banking

Interest free banking in Ethiopia has been striving for gaining some successes for the last five years. However, like Interest free banks of any other countries, it is a normal prediction that interest free banking by commercial banks has to face many challenges in Ethiopia as well. Addressing some of these challenges is critical for improving Interest free banking activities in the country. In order to identify the most important challenges faced by Islamic windows by commercial bank, a detailed questionnaire was distributed among bankers working in the area.

Table 4.15: Challenges of Interest free banking

Challenges	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Mean
Lack of Shariah advisor	6.7%	4.9%	7.9%	27.4%	53.0%	4.15
Lack of supervision by National Bank of Ethiopia	11.0%	12.2%	8.5%	20.7%	47.6%	3.82
Lack of confidence and trust of clients	4.3%	6.1%	7.3%	40.2%	42.1%	4.10
Lack of profit sharing on asset side	17.7%	18.9%	29.3%	22.0%	12.0%	2.92
Lack of suitable Interest free banking financing modes	10.4%	19.5%	15.9%	32.3%	22.0%	3.36
Lack of legal support from government	9.1%	10.4%	13.4%	26.2%	40.9%	3.79
Lack of qualified human resource	3.7%	6.1%	8.5%	28.7%	53.0%	4.21
Lack of cooperation among conventional banks Islamic windows	12.2%	18.3%	20.7%	21.4%	27.4%	3.34
Lack of infrastructure suitable for Interest free banking operation	11.6%	11.0%	8.5%	42.7%	26.2%	3.61
Shortage of supportive and link institutions	6.1%	20.7%	27.4%	27.4%	18.3%	3.31
Inadequate training and education facilities	6.7%	19.5%	11.0%	32.9%	29.9%	3.60
Higher commission and fee on transactions	16.5%	48.2%	16.5%	11.0%	7.9%	2.46
Higher tax burdens on the Interest free banking products	12.8%	19.5%	9.8%	36.0%	22.0%	3.35
Noncompliance with Shariah requirements	34.1%	32.3%	13.4%	9.8%	10.4%	2.30
Inadequate knowledge and understanding of IFB by NBE	6.1%	10.4%	16.5%	34.1%	32.9%	3.77
Inability to meet financial needs of clients for different types of funds	12.2%	23.2%	13.4%	31.7%	19.5%	3.23
Lack of Top management and organization commitment	12.2%	9.9%	9.1%	30.5%	39.3%	3.75

Source: Own Computation from Primary Data Source, March 2018

The table 4.15 shows that majority of the bankers have agreement with the statement that lack of Shariah advisor is a challenge for the operation of Interest free banking in Ethiopia. Among 164 respondents, only 11.6% of the respondents disagreed to the statement and another 7.9 % had an impartial view. Another 27.4% of the respondents were agreed to the statement but those who strongly agreed to the statement were counted to be 53%. The survey results show that almost 80.4% of the respondent agreed that lack of shariah advisor is a challenge. The reported of the above item was 4.15 which indicated agreement among the respondents regarding the lack of shariah advisor is a challenge since existence of fully functional shariah advisor is the central point for both operation and growth such banking service weather the bank is fully fledged or Islamic window of conventional banks. The above table also shows that 68.3% of the respondents agreed or strongly agreed that lack of supervision by National Bank of Ethiopia is among challenges of Islamic windows by commercial banks. Only 23.2% of the respondents disagreed to the statement and 8.5% of the respondents did not show any response to this statement. The reported mean of the statement also confirmed that there was an agreement among the respondents regarding lack of supervision by National Bank of Ethiopia as a challenge. Furthermore, the vast majority of the respondents have agreement with the statement that lack of confidence and trust of clients is a challenge for Islamic window by commercial banks. The survey results also show that 82.3% of the respondents agreed to the statement. The reported mean was 4.10 which indicate a general agreement to that statement, since growth of Interest free banking depends on public trust and confidence among clients of the bank. Moreover, 77.1% of the respondents said that lack of legal support from government is a challenge for development of interest free banking in the country. Whereas, 13.4% had an impartial view and only 19.5% respondents did not agree to the statement. The reported mean for this statement was 3.79 that indicate respondents agreed to the fact that Islamic window of commercial banks requires legal and regulatory support from the government.

According to the survey results, 81.7% of the respondents said that they agreed or strongly agreed that lack of qualified human resource is a challenge for conventional banks currently offering interest free banking products and services. There were only 9.8% respondents who disagreed to the above statement and another 8.5 % remain neutral. The above table also shows the responses of the respondents about the statement that lack of infrastructure suitable for

Interest free banking operation is a challenge for Islamic window by commercial banks. Among the sample respondents, 68.9% of the respondents agree or strongly agree lack of infrastructure which suitable for Interest free banking operation is a challenge for interest free banking operation. Furthermore, in the sample of 164, 62.8% respondents agreed that an inadequate training and education facility is a challenge for interest free operation. Whereas 26.2% respondents disagreed to the statement and another 11 did not show any response to the statement. Moreover, there were 67% of the respondents who agreed to the statement that inadequate knowledge and understanding of IFB by regulatory body i.e. NBE is a challenge for the development of interest free banking. It is also evident from the statistics shown in the above table 69.8% of the respondents agreed to the statement that lack of top management and organization commitment as a challenge. There were respondents that constituted only 22.1% of the sample who disagreed to the statement. The remaining 9.1% did not respond to this statement and remained impartial. The reported mean of the above items were between 3.61 and 4.21 which indicate a greater degree of agreement among the respondents regarding the items as a challenge for the operation of interest free banking in Ethiopia.

It is observed from Table 4.15 that the responses of the respondents to other statements which are also related to Challenges of Interest free banking. According to the survey result, lack of profit sharing on asset side (32%), lack of suitable Interest free banking financing modes (54.3%), Lack of cooperation among conventional banks Islamic windows (48.8%), Shortage of supportive and link institutions(45.7%), Higher commission and fee on transactions(17.9%), Higher tax burdens on the Interest free banking products(58%), Noncompliance with Shariah requirements(20.2%),and Inability to meet financial needs of clients for different types of funds(51.2%) are Challenges of interest free banking. However, the reported mean for the above statements were ranging between 2.3 and 3.36. This indicates a high degree of uncertainty about whether the items listed above are really challenges for interest free banking operation or not. Although the mean value items is near to neutral, the fact that some of the items such as higher commission and fee on transactions and Noncompliance with Shariah requirements towards their disagreement while the remaining items result suggest that they are uncertain about the item listed above are really the challenges for Interest free banking window by commercial banks.

4.8 Interview Analysis

The purpose of this study is to investigate practices and Challenges of Interest free banking by commercial banks in Ethiopia. As a part of research project, and mentioned in the research methodology chapter, interviews concerning key practices and challenges of interest free banking in commercial banks were conducted. A total of seven respondents were interviewed in the light of the objectives of the research and to cover some issues that might not be covered by the questionnaire. The selected bankers were in the capacity of Director or Managers of Interest free department/division except one respondent which was senior IFB financial and investment analyst and were currently serving in the Interest free banking windows of commercial banks. To help interviewees become familiar with the Issues, an explanation of the purpose of the study was provided, and then bankers were asked about different aspects of Interest free banking. The findings and discussions are presented in three sections. These are the benefit of adopting Interest free banking for conventional banks, Shariah requirements of conventional banks for adopting interest free banking and their level of compliance, and challenges of interest free banking by commercial banks in Ethiopia.

4.8.1 The benefits of adopting Interest free banking for conventional banks

One of the important developments in Ethiopian banking industry in the last five years is some conventional banks which includes some of the big banks in terms of market share in the banking industry have started using Interest free banking transactions, tools and techniques in their banking operations. The growing and particular financial needs of Muslim community motivated the management of commercial banks to incorporate the banking services compatible with the law of Shari'ah. Oromia International bank is the first commercial bank which took the initiative to introduce interest free banking products and services compatible with Islamic Shari'ah in to Ethiopian banking industry. Today, there are seven interest free banking windows of commercial banks, operating with more than 1000 branches in different parts of the country. It is a good example of the rapid expansion of Interest free banking service in the country. However, Islamic windows of commercial banks are not religious organizations or charities they had to deliver benefits to the banking industry in general as well as for banks adopting Interest free banking operation in particular. Professionals from the industry agreed that there are benefits for commercial banks for establishing Islamic window with the bank. The benefits as opined by the bankers are stated below from their perspectives.

Findings reveal that all the interviewees believe that Islamic windows are increasingly important within commercial banks and the banks' become benefited for adopting interest free banking operation with their bank. Attracting new customers, keeping existing customers, tremendous success in mobilizing deposits, enhancing the bank's brand image, revenue from IFB operations and improve competitiveness of the bank were given as examples. One of the participants stated that Islamic windows are attracting clients who do not want to involve in any interest dealings and had not had a bank account due to the presence of interest in commercial banking transaction towards the banking system including who have accounts in the conventional section. Another interviewee stated that there were significant amounts of Muslim population unbanked or under banked due to mere fact that they did not want to save their money from the institution that is based on interest. However, Islamic windows of banks are providing Interest free banking in the form of deposit mobilization and financing in trade, industry and other sectors including agriculture of the economy by bringing huge amount of immobilized funds fund into the formal banking sector which benefits the banks as well as the entire economy at lager.

According interviewees', Islamic windows have shown tremendous success in mobilizing deposits. The deposits that Islamic window of banks hold have crossed nine billion birr which is not include a more than nine billion birr hold by conventional banks in the name of 'non-interest bearing' saving account and 'special demand deposit' which is higher than some banks entire deposit that indicates the potential and the viability of this banking services. Some Islamic windows are performing well like the conventional sections. One of the participants explained that although, Interest free banking service is newly introduced for Ethiopian banking industry, it constitutes 16.36 % of consolidated corporate deposit portfolio, 12.82% of the total corporate consolidate loans and advances, 24% of total FCY generation and 34.81% to the corporate profit of the Oromia international bank. It indicates how conventional banks currently offering interest free banking products benefited from Islamic window despite the newness of the service, with limited number of products and resources, lack of experience and misconceptions about IFB products that have not been able to fully utilize the potential of a Islamic windows of commercial banks in the Ethiopian banking Industry.

To sum up, benefits of adopting Interest free banking for conventional banks, through interviewing managers/directors of IFB department/division, findings from questionnaire and

secondary data analysis, confirm that commercial banks currently having Islamic window have been benefited from the operation of Interest free banking services.

4.8.2 Shariah requirements of conventional banks for adopting interest free banking

The most essential element of an Islamic window is that all of its operations are in strict compliance with Shariah. Different scholars and practitioners have different views and thoughts concerning the compliance of Shariah by the Islamic windows of conventional banks (Sobhani et.al, 2015). There are different conditions necessary to meet the essential requirement suggested by the practitioners, Islamic scholars, and eminent world famous Shariah scholar such as Justice Mohammed Taqi Usmani and Nizam Yaquby. The most important of these required conditions are: complete segregation of funds; the existence of a Sharia supervisory board; management committed to Islamic financial concepts; safeguarding Muslim investors' funds from negligence, trespass, and fraud; and compliance with the standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). This part dealt with the interviewee results of essential requirements.

4.8.2.1 Complete segregation of funds

The first and foremost requisite for a true Islamic window is that it is carefully separated from the general side of the conventional bank (Usmani, 2002). Separation is not only a physical partition in a branch between Islamic windows and the conventional section, but also separation in all kinds of activities, functions, recording and reporting. Since the aim of the first question was to assess whether Islamic windows of conventional banks maintain a complete segregation of Interest free and conventional fund or simply it is “dressed-up” window that suspected with comingling of the two funds. The first question was: Does Islamic window of commercial banks properly maintain Interest free funds from mixing with conventional fund?

There was agreement between participants in their views that Islamic window of conventional banks including their bank maintain separate accounts, books, ledger books, and software evidencing complete segregation of funds. The reason behind that might be it is a necessary condition to obtain license for opening Islamic window. As per directives to authorize the business of Interest Free Banking, directives number SBB/51/2011, sub section 6 states that

banks engaged in interest free banking business shall keep separate books of accounts in respect of interest free banking operations and ensure proper maintenance of records for all transactions for segregation of funds. The applying bank is required to submit a proposal for opening Islamic window to the concerned department of National Bank of Ethiopia with a working paper that states services and products to be offered; Commitment to keep funds and accounts of Interest free banking completely separate from those of the conventional ones; methods of segregating the funds of the Interest free banking from the funds of conventional branches of the bank; and accounting aspects to be followed. One of the interviewees commented that even if keeping and maintaining separations in each and every case is very difficult, segregating Interest free fund from conventional ones matter is not difficult or problematic in view of the availability of modern computer systems. Despite this fact, most customers of Interest free banking as well as Muslim community at large fear their fund could be comingling with the conventional fund. One of the participants explained that most of the customers have not have sufficient understanding about how the shariah principle. Even some of the customers asked the bank to prepare a separate vault for interest free banking operation. However, shariah mostly concern about the fund raised from interest free operation will used for conventional operation rather than mixing of physical cashes. Overall, the outcomes of interviewees with managers or directors of Interest free banking department/division are consistent with the questionnaire findings.

4.8.2.2 Sharia Supervisory Board

Shariah boards are the basic need for a true and sound Interest free banking. Fully functional Shariah supervisory board consisting of reputable and experience Islamic shariah scholars is integral part of any Islamic banks including Islamic window. There need to be a minimum 3 shariah scholars with one being the chairman (Malim, 2012).If conventional banks Islamic windows have their own Shariah boards which is fully functional that ensured that all the requisites for a true Islamic window are fulfilled in letter and spirit, there should not be a room to criticize conventional banks merely having Interest free window. So that, participants of interviewees were asked does their bank have a shariah supervisory board or shariah advisor? Unfortunately most of the commercial banks offering Interest free banking products and services in Ethiopia have not have Shariah boards to play basic roles in promoting Interest free banking and adherence to Shariah principles. Only two banks have their own Shariah boards and another

two banks have external shariah advisory to validate contracts. The remaining three banks have neither shariah advisor nor shariah board. In view of the interviewees' responses, it is evident that the lack of shariah advisor is a big issue for Islamic windows in Ethiopia, since no new operation is undertaken without prior approval from the board as well as the board or advisor must read and approve every single contract of the bank and also their other financial activities and transactions. According to participants', it might be possible to maintain full Shariah guidelines regarding deposits, it is very difficult to maintain shariah principles regarding financing and investment without having shariah board or advisor which monitor and validate the contracts feature and the nature of business in which Islamic windows going to invest or finance.

Even though some of the respondents concerns about the functionality and independency of shariah board, those banks having shariah board argue that banks able to pursue clients of confidence in their operations since the banks hired Shariah scholars who are well versed in the Shari'ah and also in banking and finance. They argued that having shariah scholar is not important only from shariah point of view but also business point of view which enable conventional banks Islamic window to pursue a good market share by having reputable and credible sharia scholars. Some others argued that even though there are many scholars in Ethiopian well versed in the religious matter, there are only few scholars who have well versed in both shariah and banking matters. So, they recommend that to have a common Shariah board with the cooperation of the national bank of Ethiopia. This Central Shariah Board gives opinion and guidelines to implement and comply with the Shariah principles in both deposit and financing activities of the Islamic window of conventional banks and provide a clearance of Shariah compatibility of all products. It oversees the activities of the bank from Shariah perspective. These results support the analysis of the questionnaire in the analysis part of the study.

4.8.2.3 Managerial Commitment

Interest free banking with in conventional banks is treated as virtual bank within bank. Managing these different types of banking activities under one umbrella is not easy. Unless the entire management of conventional banks is committed and convinced, the interest free banking business will not be free from deviation and irregularities. The success of the Islamic Window

will depend purely on the acceptability of the Islamic initiative by the front-end function of the conventional bank and how they adapt the Islamic banking themselves. These windows are not religious organization but a profitable section of the bank. However, some managers of conventional banks consider interest free banking business as a supportive division rather than an operational and profitable section of the bank. Most of the interviewees agreed that Islamic windows have not had fully support that should be pursued. One of the interviewee replied that there is a pervasive misconception among senior management of banks including shareholder of the bank considering interest free banking as ‘promoting Islam’.

4.8.3 Challenges of Interest free banking

Interest free banking in Ethiopia has been striving for gaining some successes for the last five years. However, like Interest free banks of any other countries, it is a normal prediction that interest free banking by conventional banks has to face many challenges in Ethiopia as well. Addressing some of these challenges is critical for improving Interest free banking activities in the country. Since this study attempted to identify the challenges of interest free banking operating in Ethiopia, these the challenges as identified from the interviewees with bankers of Interest free banking by conventional banks stated below:

4.8.3.1 Doubt of the clients

The growth of Interest free banking depends on public trust and confidence among the wider community. However, many people still have some doubts about Shari’ah compliance of Islamic windows by commercial banks and they are not fully satisfied with the authenticity of products and services offered by these windows and they have many questions unanswered. So that number of clients is not confident and comfortable to deal with Interest free products of commercial banks and they ask Islamic window products of conventional banks are purely based on shariah principles or not. In fact majority of Muslims have very little understanding of Interest free banking and other economic concepts of Islam and there was not any consensus on the issue among the scholars. Doubt of the clients is a great challenge for the Interest free banking managed by the commercial banks in Ethiopia.

4.8.3.2 Lack of supervision by National bank of Ethiopia

Supervision of Islamic window by commercial banks is as important as that of the conventional section since both sections of the bank manage public money and regulation and supervision of

these banking activities ensure transparency and the soundness of the financial system. National bank of Ethiopia issued a directive in 2011 which identified terms & conditions for the banks to obtain license for operating Interest free banking. This directive contains a narrow scope regarding activities of Islamic banking within conventional banks. Absence of separate act and comprehensive standards covering all areas for the Interest free banking activities including prudential regulation, internal controls, risk management and corporate governance incorporated in the amended Banking Business Proclamation Number 592/2008. National bank of Ethiopia has not been set up any separate department to control, guide and supervise the operation of the Islamic windows by commercial banks. So, ensuring implementation of the basic requirements by commercial banks to operate interest free banking business is difficult. At present, lack of supervisory framework is one of the challenges of the prevailing Interest free banking system and deserves serious attention.

4.8.3.3 Lack of legal support from government

Every banking system whether conventional or Islamic requires legal and regulatory support from the government. Islamic windows by conventional banks are not exception, as they need a number of legal supports from the government to perform their various essential activities. Islamic windows by commercial banks in Ethiopia governed by banking business proclamation and associated directives, tax laws, lease proclamation and any other laws of the land. However, some of these laws are not tailored with the business and product nature of interest free banking and products and services. Interest free banking products such as murabaha, simply put, is an Interest free banking product where the seller (Islamic window) and buyer (the bank's client) agree on the mark-up for the items being sold to the buyer by the seller. In the event that the item is vatable the transaction will trigger VAT both at the point the bank is acquiring it and at the point the bank is 'selling' it to the customer. Since there is no specific tax directive for Interest free banking products that remove double taxation or any tax associated with trading or leasing of asset, the cost of acquisition of an asset under an Islamic finance arrangement will be considerably high for the customer. Moreover, according to the directive number SSB/60/2015(Limitation on the investment of banks) which states that bank shall hold up to 10% equity share in a single non- bank business other than insurance. This directive limit the both the interest and risk appetite of banks to engage in typically of profit and loss investment business

mudaraba and Musharaka. Furthermore, the Banking proclamation prohibits banks from purchasing or acquiring or holding any land reasonably necessary for the purposes of constructing office or conducting its business which the limit the banks interest to invest on diminishing Musharaka, Istisna and Salam types of financing and investing activities. Lack of legal support from government is a big problem for the development of interest free banking in the country.

4.8.3.4 Lack of skilled professionals

Interest free banking is dependent on professional and experienced banking personals as conventional banking system. Although commercial banks recruited both Muslim and Non-Muslim employees to conduct interest free banking activities and organize foundation training programs for recruited employees, they prefer to serve in the conventional banks because of competitive benefit packages and promotion. The respondents also acknowledge that there is difficulty to find skilled and technically sound workforces on the issues related to shariah auditing to ensure Shariah compliance. Moreover, interest free banking has been growing for the last five years and expected to gradually expand over the coming years and will eventually complement conventional bank offerings by providing an accepted interest free investment and financing offerings. However, lack of skilled and trained professionals to fulfill the requirements of the growing Interest free banking service in the country is a major challenge to the promotion and growth of interest free banking in Ethiopia.

Chapter Five

Conclusion and Recommendation

The study was an attempted to know challenges of Interest free banking managed by commercial banks in Ethiopia and to evaluate them empirically. From the result of the survey, in-depth interview and reviewing of secondary sources so far attempt been made to present and analyze the data. This chapter provides the conclusions and recommendations in line with the findings of the study. The chapter is structured in to two sections. The first section deals with the conclusions whereas the second presents some recommendation suggested as a solution to problem that has been identified in the study.

5.1 Conclusion

The main research findings related with research objectives are given below as bullet points.

- More than half of conventional commercial banks in Ethiopia are adopting interest free banking service. Interest free banking services are increasingly important within banks since banks started to enjoy the benefits. The result from study revealed that Interest free banking service helps commercial banks to keep existing customers of the bank who are opting to switch to other banks and attract new customers from other banks that did not start to offer IFB services. The number of customers and deposits also increased when banks start to provide Interest free banking products. The survey also revealed that interest free banking service benefits banks to improve competitiveness and enhance bank's brand image by serving as an alternative banking system. Interest free banking services have been benefiting, not only in terms of increasing customers and mobilizing deposits, but also some banks enjoy greater profitability and FCY generation. This indicates commercial banks currently having Interest free banking window have been benefited from the operation of Interest free banking services.
- Majority of the branch managers and staffs of interest free banking department/division have little awareness about most of Interest free banking product. Their understanding

about interest free banking products limited to Wadiah/Amana and murabaha mode of deposit and finance currently provided by most of Interest free banking windows of commercial banks in Ethiopia. However, a significant number of the respondents are not aware of the mudarabah, Musharaka, Ijara, Salam and Istisnaa.

- The basic awareness of the customers and their essential knowledge about Interest free banking and Shari'ah based products and services in the market have positively influenced their perception and usage towards the Interest free banking. However, majority of the account holders did not well understand the basic principle used in interest free banking. Furthermore, it is unlikely to aware every type of interest free banking products and services, but the majority of account holders little aware or unaware for most of interest free products. Most of account holders have familiarity only with Al-Wadiah, Amana and Quard saving and current accounts. Only few number of account holders being aware of investment and financing types of interest free banking products, even though they did not deal with them. Surprisingly, a significant number of the accountholders skeptic about Interest free banking window of banks' ability manage their fund and Shari'ah compliance these windows. They also have doubts about Interest-free banking window and think that Interest-free banking windows are not different from the conventional ones, except for the use of a few Arabic terms to suggest Shariah compliance.

- Conventional banks allowed to operating interest free banking services as long as they provide services in accordance with Shariah principle and conditions necessary for conventional banks to comply with and implement when doing so. Interest free banking windows of commercial banks in Ethiopia is segregate Interest free fund from conventional fund through separate accounts, books, ledger books, and software evidencing complete segregation of funds. Maintaining fully shariah compliance ensured by shariah board of Interest free banking window, but only two banks have their own fully functional Shariah boards. The survey result also revealed that some banks management and shareholders are not committed in promoting Interest free banking

products and services. With the absence of shariah board and audit and the entire management and shareholders aren't committed and convinced, it is difficult for commercial banks currently offering interest free banking products, to fully comply with shariah principles.

- In the process of offering interest free banking services, it seems that there are many challenges the practitioners of Ethiopia have been facing. The major challenges as identified by the respondents are lack of Shariah advisor, lack of supervision by National Bank of Ethiopia, lack of confidence and trust of clients, lack of legal support from government, lack of qualified human resource, lack of cooperation among conventional banks Islamic windows, lack of infrastructure suitable for Interest free banking operation, Inadequate training and education facilities, Inadequate knowledge and understanding of IFB by NBE, lack of top management and organization commitment, and doubt of clients. This is consistent with the studies of Mohamed (2011) and Kerima (2016) who observed that some of the Challenges listed above are the Challenges for the operation of interest free banking service in Ethiopia.

5.2 Recommendations

In line with the findings and conclusions made the researcher gives the following possible recommendation forwarded.

- Shareholders, board of directors and the management of the bank should accept the concept and be cooperative with interest free banking window of the banking since these banks have been benefited from IFB services.
- Bank and other stakeholders should embark on vigorous public enlightenment programmes to create more awareness and to remove misconception and doubt among Muslim and non-Muslim through public lectures, conferences, symposia, seminars and publication of books, journals, magazines and pamphlets.
- Conventional commercial banks should establish a working Shari'ah supervisory board (SSB) for interest free banking operation and strictly comply with its guidance. Alternative to an independent shariah board, banks currently offering interest free

banking work together to have a common Shariah board that determine the Shariah compatibility of the Interest free banking operation and products.

- National bank of Ethiopia, should design comprehensive and robust regulation with consultation with stakeholders in the industry as well as Muslim community at large. NBE should also establish a separate department for handling all issues relating to Interest-Free Banking and closely monitor and supervise the operation of interest banking windows of conventional banks.
- The government of Ethiopia should take more proactive efforts to promote Interest free banking services with certain amendments laws and regulations such, tax, leasing, banking proclamation.

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Glossary of Arabic terms

Amanah	a contract under which an object or a bank deposit is held on trust
Al-Qur'an	Muslims' Holy book, means the noble Qur'an
Damam	Responsibility
Fatwa	ruling by a scholar of Islamic jurisprudence such as those serving on the shari'ah boards of Interest free banks
Fiqh	Islamic jurisprudence
Gharar	legal uncertainty such as contractual ambiguity which could result in one of the parties to a contract exploiting the other
Ghorm	Risk Taking
Halal	permissible under Islamic law by being Shari'ah compliant
Harām	Prohibited
Ijara	an operational leasing contract where the owner responsibilities justifies the payment of rent.
Ijma'	Consensus of opinions collectively agreed among Shariah scholars
Ijtihad	The interpretation by a trained scholar, such as those serving on the Shari'ah boards of Islamic financial institutions, of how Shari'ah should be applied in new circumstances.
Istisna'a	The sales contracts that requires the manufacturer of the good or the contractor of facility to exact specifications that are stipulated before the work commences.
Kasb	Work and Effort
Maysir	A game of chance involving gambling. Activities such as spread betting financial markets are prohibited under <i>Shari'ah</i> as they are regarded as addictive and contribute nothing to society or an economy.
Mudaraba	a partnership contract between an investor, the <i>rabb al maal</i> , and a business manager, the <i>mudarib</i> , which provides for profit sharing, with the <i>rabb al maal</i> receiving a return on their financial investment

while the mudarib receives a share of the profit assessed on the basis of the value of their effort.

Murabaha	a sale contract whereby an Islamic financial institution sells a good to a client who makes deferred payments including a profit markup.
Musharaka	a partnership contract between investors whereby they obtain predetermined shares in any profits generated. The partners take an active role in management, the extent of that activity being defined in the contract.
Qard Hasan	an interest-free loan, the only type of loan agreement permissible under Shari'ah. Although Islamic financial institutions cannot profit from the loan, they may levy a set-up fee and an annual management levy to cover administrative expenses.
Qiyas	Analogy
Riba	an addition to the principal of a loan, which is usually equated with interest.
Riba al Nasi'ah	Riba of Delay
Riba al- fadl	Riba of excess
Salam	advance payments in full for a commodity for delivery at a future date. This contract was originally used for the financing of agricultural production with the advance payment being used by farmers to cover labour, seed, irrigation and other costs during planting and cultivation while benefiting from a fixed price on harvesting.
Shari'ah	the Islamic law based on the Divine guidance provided by the Quran and the Sunnah, practices or 'way' of the Prophet during his life
Sunnah	Teachings of the prophet Mohammad (PBUH); they said about anything, they act anything is called as Sunnah
Wadiah	a peculiar non-earning type of IFB deposit that operates under the contract of Wadiah Yad Dh amanah (guaranteed custody).

Annex

አዲስ አበባ ዩኒቨርሲቲ

ቢዝነስና ኢኮኖሚክስ ኮሌጅ

ከወለድ ነፃ የባንክ አገልግሎት ተጠቃሚ ደንቦች መጠይቅ

ይህ መጠይቅ የአዲስ አበባ ዩኒቨርሲቲ በቢዝነስ አመራር ማስተር ተማሪ የተዘጋጀ ሲሆን አላማው በኢትዮጵያ ውስጥ የሚገኝ ባንኮች ስለሚሰጠው ከወለድ ነፃ የባንክ አገልግሎት መረጃ መሰብሰብ ነው። መረጃ የሚያገለግለው ለጥናቱ ርዕስ “በኢትዮጵያ ባንኮች ውስጥ በመሰጠት ላይ ስላለው ከወለድ ነፃ የባንክ አገልግሎት ተያይዞ ስለሚነሱ ችግሮች አና ተግዳሮቶች” የሚውል ነው። የሚሰበሰበው መረጃ ለጥናቱ ብቻ የሚውል ነው።

ስለዚህ የእናንተ መጠይቁን በትክክል መሙላት ጥሩ ጥናት እንዲደረግ ይጠቅማል እና እባክዎን የሚከተሉትን ጥያቄዎችን በትክክል ይሙሉልን። ለትብብርዎት በቅድሚያ እመሰግናለሁ።

ማብራሪያ ቢያስፈላግም በዚህ አድራሻ ያግኙኝ

ስልክ፡ 0910305628

ማሳሰቢያ

1. ስምዎንን መፃፍ አያስፈልግም
 2. ለሁሉም መጠይቅ የተሰጡትን አማራጮች አክብቡ
 3. በሚያስፈልግበት ቦታ ከአንድ በላይ መልስ መምረጥ ይቻላል
- መድብ አንድ፡ የግል መረጃ**

1.1 ጾታ

ወንድ ሴት

1.2 የትኛው የሀይማኖት ክፍል ውስጥ ናት?

ሙስሊም ሙስሊም ያልሆነ

1.3 ከዚህ በፊት ባንክ የመጠቀም ልማድ ምን ይመስል ነበር ?

መደበኛውን ስለወለድ የቁጠባ እና ተንቀሳቃሽ የባንክ አገልግሎት

ወለድ የማልቀበልበት የቁጠባ እና ተንቀሳቃሽ የባንክ አገልግሎት

ባንኮች ወለድ በመክፈላቸው የተነሳ የባንክ አገልግሎት ተጠቃሚ አልነበርኩም

በሌላ ምክንያት የባንክ አገልግሎት ተጠቃሚ አልነበርኩም

1.4 የወለድ ነፃ የባንክ አገልግሎት መጠቀም ከጀመሩ ስንት አመት ይሆነዎታል?

ከአንድ አመት በታች ከ1-2 አመት ከ2-5 አመት

1.5 የትኛው የወለድ ነፃ ሂሳብ ጋር ነው ትስስሮ? (ከአንድ በላይ መምረጥ ይቻላል)

የአደራ ተንቀሳቃሽ ኢንቨስትመንት ፋይናንስ

ክፍል ሁለት ፡ ደንበኞች ስለ ወለድ ነፃ የባንክ አገልግሎት ያላቸው ግንዛቤ ለመለካት

ደንበኞች ስለ ከወለድ ነፃ የ ባንክ አገልግሎት ስርዓት እና አሰራር ያላቸው ግንዛቤ ለመለካት ያስችል ዘንድ ከታች ከተዘረዘሩት ዓ/ነገሮች መካከል እንደ መስማማቶ መጠን ከታች በቀረቡት አማራጭ መሰረት ይህን ምልክት/ ያድርጉ።

1.በጣም አልስማማም 2.አልስማማም 3.ገለልተኛ 4.እስማማለሁ 5.በጣም እስማማለሁ

ተ.ቁ	ጥያቄ	አማራጮች				
		1	2	3	4	5
1	ከወለድ ነፃ የባንክ አሰራር ቁልፍ ፅንሰ ሀሳቦችን ተረድቻለሁ					
2	ከወለድ ነፃ የባንክ አገልግሎት አሰራር እና የሻሪያ መርሆዎችን ሙሉ በሙሉ እረዳለሁ					
3	በወለድ እና ከወለድ ነፃ የባንክ አገልግሎት የቴክኒካዊ ልዩነቶችን እና ዘዴዎችን ተረድቼያለሁ					
4	ከወለድ ነፃ የባንክ አገልግሎት ውስጥ የእኔን ተቀማጭ ቁጠባ እና ተቀማጭ ገንዘብ ባንኩ እንዴት እንደሚያውለው እገነዘባለሁ					
5	በኢትዮጵያ ውስጥ ስለሚሰጡ በወለድ ነፃ ባንክ አገልግሎቶችን እና ጥቅም ግንዛቤ እለኝ					

ክፍል ሶስት፡ ደንበኞች ስለ ወለድ ነፃ የባንክ አገልግሎቶችን(ፕሮዳክትስ)ያላቸው ግንዛቤ ለመለካት

ደንበኞች ስለ ከወለድ ነፃ የባንክ አገልግሎቶች(ፕሮዳክትስ)ያላቸው ግንዛቤ ለመለካት ያስችል ዘንድ ከታች ከተዘረዘሩት ዓ/ነገሮች መካከል እንደ መስማማቶ መጠን ከታች በቀረቡት አማራጭ መሰረት ይህን ምልክት/ ያድርጉ።

ተ.ቁ	የባንክ አገልግሎት	ሙሉ-በሙሉ-ተረድቻለሁ	አነስተኛ ግንዛቤ አለኝ	ሙሉ በሙሉ አላወቁም
1	ስለቀርድ			
2	ስለአማና			
3	ስለዋድያ			
4	ስለሙዲረባ ኢንሸስትመንት ተቀማጭ			
5	ስለሙራባሃ			

6	ስለኢጃራ ስለሙዲረባ			
7	ስለሰላም			
8	ስለኢስቲስና			
9	ስለሙዲረባ ኢንሽራንስ			
10	ስለሙሻረካ			

መድብ አራት: ስለ ወለድ ነፃ የባንክ አገልግሎቶች እና ስለ ወለድ ነፃ የባንክ መስኮቶች ደንቦች የላቸውን ምልክታ ስለ ለመለካት

ተ.ቁ	ጥያቄ	1	2	3	4	5
1	ከወለድ ነፃ የባንክ አገልግሎት የደንቦችን ገንዘብ በደንብ ያስተዳድራል ብዬ አላምንም።					
2	ከወለድ ነፃ የባንክ አሰራር ለባህላዊው አሰራር ባንኮች ጥሩ አማራጭ ነው።					
3	በባህላዊ ባንክ ውስጥ ያሉ ከወለድ ነፃ የባንክ መስኮቶች የሻሪያ መርሆዎችን የተከተሉ ናቸው ብዬ አምናለሁ።					
4	በኢትዮጵያ ውስጥ ለ ወለድ ነፃ የባንክ አገልግሎት እውነተኛ ፍላጎት አለ።					
5	ከወለድ ነፃ የባንክ መስኮቶች ከተወሰኑ አረብኛ ቃላት ከመጠቀሙ በስተቀር ከባህላዊው የባንክ ስርዓት የተለየ አይደለም።					
6	ደንቦች ስለ ከወለድ ነፃ መስኮቶች አገልግሎት ጥርጣሬ አላቸው።					
7	ከወለድ ነፃ የባንክ መስኮቶች ሰራተኞቹ ስለ አሰራሩ በቂ ግንዛቤ የላቸውም እና በመስኩ ላይ ብቁ አይደሉም።					

መድብ አምስት:

1. ከወለድ ነፃ የባንክ አገልግሎቶች እንዲይጠቀሙ ችግር ወይም ተገዳሮት የሆኑት ጉዳዮች ካለ ቢዘረዝሩልን

2. ከወለድ ነፃ የባንክ አገልግሎቶች ጋር በተያያዘ ከላይ ለተጠቀሱት ችግር ወይም ተገዳሮት ሞፍትሄ ይሆናል ያሉትን ቢጠቅሱልን

3. በአጠቃላይ ከወለድ ነፃ የባንክ አገልግሎቶች በተያያዘ የእናንተ ምልከታ ቢያሰፍሩልን

ክልብ እሙሰግናሊሁ
ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF BUSINESS ADMINISTRATION

SCHOOL OF GRADUATE STUDIES IN BUSINESS ADMINISTRATION

Questionnaire for data collection on the topic: “PRACTICES AND CHALLENGES OF INTEREST FREE BANKING IN CONMMERCIAL BANKS INETHIOPIA”

Questionnaire to be filled by Bankers

Dear Respondent,

I would like to express in advance my deep appreciation for your generous time, honest and prompt responses. This is a questionnaire for research that seeks to describe the attitudes and awareness of bankers (Branch managers and staffs of Interest free department of conventional banks) on the challenges Interest free banking within conventional banks in Ethiopia. The survey is conducted as part of the researcher’s MBA (Finance) programme at the Addis Ababa University and therefore responses will be used purely for academic purposes. Your anonymity

is assured and all responses given will be held in due confidence. It might take you around 15 minutes to complete the questionnaire. Your participation is really important for the success of this research. Thank you so much for your help. I really appreciate it.

Jemal Nassir

Mobile: +251910305628

E-mail: jemal0668@gmail.com

Thank you in advance for your cooperation!

General Instructions

1. No need of writing your name.
2. Please fill the answer by putting “√” mark.
3. Please return the completed questionnaire as much as possible
4. If you need further explanation, you can contact me through the address mentioned above.

PART I: General Information

In this part you will find some general issues regarding the level of education, employment and banking experience. Please click on the box that represents the appropriate response to you.

Section A: Information on the Bank

1. Name of Bank _____
2. Branch name _____
3. Your position _____

Section B: Demographic Information

1. Gender: Male Female

2. Age: 18-27 28-37 38-47 48-57 57 and above

3. What is your highest level of education?

Up to Diploma First Degree Masters PhD

4. How many years do you have in current employment?

<1 Year 2-4 Years 5-7 Years 8>Years

PART II: ATTITUDE AND KNOWLEDGE TOWARDS INTEREST FREE BANKING

This part is divided in to three sections; in each section there are statements which address issue about the benefits of practicing Interest free banking within conventional banks, and bankers awareness attitude about concepts of Interest free banking and interest free banking products. Therefore, please read each of the statements in each section and rate your level of agreement or disagreement with each statement by using a tick mark „√“ on one of the five alternatives.

Section A: BENEFITS OF PRACTISING INTEREST FREE BANKING

The following statements indicate benefits related to the practice of interest free banking within conventional banks currently offering IFB products and services. Please state your level of agreement for each given statement using the following scales:

1 = strongly Disagree 2= Disagree 3= Neutral 4= Agree 5= Strongly Agree

No	Items	1	2	3	4	5
1	Interest free banking serve as an alternative banking system					
2	Interest free banking helps to keep existing customers who are opting to switch to other banks					
3	Interest free banking helps to attract new customers from existing banks					
4	Interest free banking improve competitiveness of the bank					
5	Number of customers increased when providing Interest free banking products					
6	Interest free banking increase our customer base					
7	Interest free banking enhance bank's brand image					
8	Deposits increased with introduction of Interest free banking					
9	Interest free banking products are meeting the financial needs of Muslims customers					
10	Interest free banking increase comfort levels of Muslim customers					
11	Interest free banking enable the bank provide variety of products for					

	customers					
12	Interest free banking able to offer viable and competitive financial products					

Section B: Knowledge of bankers towards the interest free banking products on offer in Ethiopia

To what extent are you aware of the following Interest free banking and Interest free banking products?

No	Interest free banking	Fully Aware	Little Awareness	Fully unaware
1	Murabaha (mark-up principle)			
2	<i>Musharaka</i> (joint venture)			
3	<i>Mudharabah</i> (trust financing)			
4	<i>Ijarah</i> (leasing)			
5	Salam (purchase order) financing			
6	Istisnaa (pre-paid purchase)			
7	<i>Wadi'ah</i> (safe-keeping contracts for current deposit)			
8	<i>Wakalah</i> (safe-keeping contracts for agency contracts)			
9	Quard Hassan			

PART III: SHARIA COMPLIANCE

Below is a list of sharia requirements for conventional banks establishing Islamic window and offering sharia Compliant Products and Services". For each of the questions below, Please indicate the response that best characterizes how you feel about the statement, where: 1= strongly Disagree, 2=Disagree, 3=Neutral, 4=agree, 5=strongly agree

Sharia compliance	1	2	3	4	5
Complete Segregation of Funds					
The funds mobilized through Interest free banking is commingled with the funds of the deposits mobilized through conventional branches.					
The deposits received by the Islamic window is not mixed up with the deposits taken on conventional side					
The funds sourced through Interest free banking activities are kept separate from the conventional activities of the bank and are only invested in Shariah-compliant investments.					
Conventional capital is used for Shari'ah compliance					
The bank maintain firewall between Interest free banking and conventional liabilities					

Interest free banking of the bank has an effective system in place to separate Islamic assets and funds from conventional ones					
The bank maintains a separate accounts, books, and records for Interest free banking					
The bank maintains a separate balance sheet and Interest free banking books					
Sharia Supervisory Board					
The our bank establishes a working Shari'ah supervisory board (SSB) and strictly comply with its guidance					
Shariah board acts as a watchdog while issuing different products					
Shariah scholars play their role while issuing different products					
There is no new operation which is undertaken without prior approval from the board.					
The Shariah Board regularly monitors the functions and operations of the windows (Shariah audit)					
The Shariah Board practically engaged in meetings with bank's personnel, direct customer interaction, visiting banks various premises to engage and review Interest free banking activities					
Managerial Commitment					
Conventional banks lack real commitment to the development of Interest free banking					
Our bank management shows commitment in marketing and promoting Interest free banking products and services					
The management of the bank is committed and dedicated to run its business according to the principles governing Interest free banking					
The bank has a proper institutional framework for Interest free banking system rides on the back of conventional Banking system.					
The Interest free banking have got the same respect as other businesses within the bank					
Interest free banking's are viewed mostly as a support division, rather than an operational division					
Managements of the bank fear cannibalization of conventional banking by Interest free banking					

PART IV- CHALLENGES OF PRACTISING INTEREST FREE BANKING

The following statements indicate challenges related to the practice of Interest free banking. You asked to indicate your level of agreement on the extent of the challenges your bank or other banks faced or are facing Interest free banking within Ethiopia in Ethiopia. Please indicate each of the challenges as per the scale provided. Key: 1- **Strongly disagree** 2- **Disagree** 3-**Neutral** 4-**Agree** 5- **Strongly agree**

ITEMS	1	2	3	4	5
Lack of Shariah advisor					

Lack of supervision by central banks					
Lack of confidence and trust of clients					
Lack of profit sharing on asset side					
Lack of suitable Interest free banking financing modes					
Lack of legal support from government					
Lack of qualified human resource					
Lack of cooperation among conventional banks Islamic windows					
Lack of infrastructure suitable for Interest free banking operation					
Shortage of supportive and link institutions					
Inadequate training and education facilities					
Inability to meet financial needs of clients for different types of funds					
Higher commission and fee on transactions					
Higher tax burdens on the Interest free banking products					
Noncompliance with Shariah requirements					
Inadequate knowledge and understanding by regulators					
Inability to meet financial needs of clients for different types of funds					

Part v: Open ended question

Q.1. how would you evaluate the benefit of Islamic windows by conventional banks in Ethiopia?

Q.2. what is the importance of Shari’ah compliance in your bank? What factors influence Shari’ah Compliance?

Q.3.What are the challenges being encountered by the Islamic windows?

Q. 4. Any other comments about Interest free banking (please specify);

Thank you

Interview Question for director/ manager of IFB

1. How your bank currently offers IFB products and services and what type of Interest free baking service it offers?
2. What are the benefits of adopting interest free banking system in the bank?
3. How far are the operations of Interest free banking windows in strict compliance with Shariah requirements?
4. Does Interest free banking window of your banks properly maintain Interest free funds from mixing with conventional fund?

5. Does their bank have a shariah supervisory board or shariah advisor? If yes, does the Shariah Board regularly monitor the functions and operations of the windows? If not, why?
6. Do the management and shareholders of the bank committed to promote interest free banking within the bank?
7. What are the challenges being encountered by the Interest free banking windows of conventional banks in Ethiopia?
8. What can be done to enhance of Interest free banking service in Ethiopia?