



**Challenges of Interest Free Banking Window in Ethiopia:
The Case of Dashen Bank S.C.**

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Declaration

I, Feysel Abdu, declare that this thesis is my original work and has not been presented for a degree in any other university and that all sources of materials used for the thesis have been fully acknowledged.

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Acronyms and Abbreviations

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institution
ACD	Alternate Channel Department
ATM	Automated Teller Machine
BOD	Board of Directors
CEO	Chief Executive Officer
DB	Dashen Bank
EMC	Executives Management Committee
ETB	Ethiopian Birr
FCY	Foreign Currency
GIFR	Global Islamic Finance Report
IF	Interest Free
IFB	Interest Free Banking
IFI	Islamic Financial Institution.
IFSB	Islamic Financial Services Board
IIBI	Institute of Islamic Banking and Insurance
KES	Kenyan Shilling
MSME	Micro, Small and Medium Enterprise
POS	Point of Sale
QUAL	Qualitative
SAC	Shari' ah Advisory Committee
SID	Strategy and Innovation Department

Abstract

The main goal of this study is to look at the challenges of interest-free banking in Ethiopia. Interest-free banking was launched in Ethiopia as an alternative to the banking industry within the existing conventional bank in window bases, and it operates in accordance with Shari' ah principles. However, lack of Shari' ah governance and dispute resolution system, cannibalization with conventional wing and lack of ownership, core banking system limitation and segregation of IFB fund, scramble in IFB marketing mix and product development have all hampered its activities. The study employed qualitative methods of analysis, with primary data collected through in depth interviews to test research objectives and respond to research questions. To achieve the objectives of the study interviewees were drawn from Dashen Bank S.C. Data was acquired via a semi structured in depth interview and purposive sampling from a sample of 19 IFB employees, of whom 10 of them interviewed. The results were examined using thematic analysis methods. The result showed that lack of robust Shari' ah governance framework is the major setback to the operation of interest free banking, lack of ownership and commingling of funds lagged the operations of Interest free banking; capacity limitation on core banking system and loopholes in IFB organizational structure are also affected the growth of IFB business. Some scrambles in product development and IFB marketing mix (charging higher price than conventional price, weak distribution channel in case of click & Mouse technology and, undiversified IFB products and absence of Shari' ah screening in IFB promotion) makes very limited provision for the operation of IFB in Ethiopia; and these key findings show that a major setback to the operation of IFB in Ethiopia found as institutional drawbacks. Weak and lack of supervisory framework, entry of Full fledge IFB banks and expansion of IFB dedicate branches by other banks, lack of institutional capacity are the major country level constraints found by the study.

Key words: Interest Free Banking, Sharia, Challenges.

Chapter One

1.1 Introduction

As defined clearly in NBE directive number SBB/79/2019, Interest Free Banking is a banking business in which mobilizing or advancing funds is undertaken in a manner consistent with Islamic law or Shari' ah principles.

Though the business seems to be familiar and needed badly, there is, however, an overall lack of research regarding the challenges of IFB business.

Therefore, this study tries to make an endeavour to bridge the gap and explain the major challenges faced by IFB business in Ethiopia, which the author believes to have an essential contribution for growth of the business.

This chapter will provide an introduction to the study by first discussing the background of the study and followed by the research questions, objectives, definitions, the significance and finally, the scope of the study.

1.2 Background of the study

According to Homer (1977), the struggle of man to liberate him from the depredation of interest is as old as history itself, and predates even the mining of money.

Hammurabi, who ruled Babylonia from 2123 to 2081 B.C., has left us the oldest book in the world in the shape of his code, which not only prescribes maximum rates of interest for various varieties of loans but also suggests the method of profit and loss sharing to avoid interest, as has been argued the Jewish Encyclopaedia (1905). This is besides occasion on which no interest can be claimed. (Encyclopaedia of Religion and Ethics, 1921)

All great religions, philosophers like Aristotle, renowned poets like Dante and famous Economists like Keynes have also opposed interest and repeatedly meet with repulsion for this institution. As Keynes puts it; "for several millenniums, enlightened opinion held for certain and obvious... the doctrine that the rate of interest is not self-adjusting at a level best suited to the social advantage..."(Keynes, 1936).

Aristotle in his Money & politics stated that “Interest is an artificial profit, which does not enter in legal trading. Using money as a commodity is selling, just a forged artificial transaction. Money has to be used as a means of sale and purchase and a measurement of commodity to be sold or purchased. Money is just a means to ascertain value of commodity and it cannot be sold or purchased within similar quantities.”

On the other hand, the contributions of Abrahamic religion for abstinence of interest were also very clear. For instance, the first interest free bank, by the name of Agibi, was started by the Jews in Babylonia in 700 B.C. (Baron, 1958). The basis adopted was mortgage of some productive asset like a house, a piece of land, a horse or slave etc., which the borrower parted with and the bank hired out in exchange of a loan without interest.

On mid of 15th century under the patronage of Christian church, the concept first interest free loans were given following the precedent of Babylonian and Greek temples. Montes Pietatis, as the lending institutions running based upon interest free were established (Homer, 1977).

According to Ahmed, Rehman and Valie (1995) under the leadership of Dr. El Naggat there was also an effort to attract small saving and support petty investments of productive character, which paves the way to another interest free institution under the Islamic concept in Egypt. The effort was based on a small scale pioneering experiment on the basis of profit and loss sharing in the shape of MitGhamr Saving Bank.

Moreover, before the advent of IFB, fund providers who wanted to avoid interest on their funds would place their funds with conventional banks in current and other non-interest-bearing accounts. However, this resulted in the loss of inherent earning ability of their funds which challenges the commercial sense of this transaction.

The forgoing points, therefore, exemplifies the reliability of Interest Free concept as a workable substitute for interest and the need to explore the system deeply and frequently for the inclusion of unbanked and other society who do not want to transact bank interest rate for religious or other justifiable reasons.

1.3 Background of the company

Under section company profile of Dashen Bank original website, Dashen Bank was founded by eleven visionary shareholders and veteran bankers with initial capital of Birr 14.9 Million in September 1995. According to the website, up on securing license from National Bank of Ethiopia, Dashen opened its door for service on the 1st of January 1996 with eleven Branches. Dashen Bank coined its name from the highest peak in Ethiopia, mount Dashen, and aspires to be best in class Bank in Africa.

The Bank headquartered in Addis Ababa and it operates through a network of more than 437 Branches, ten dedicated Forex Bureaus, 391 ATMs and 1592 plus point-of-sale (POS) terminals spread across the length and breadth of the nation. It has established correspondent banking relationship with 409 banks covering 69 countries and 165 cities across the world. Currently the Bank is under aggressive expansion and has created job opportunities for over 10,000 citizens.

Dashen Bank is the first bank in Ethiopia to provide a full fledged payment card service as an exclusive partner of AMEX as well as Member of VISA, Master card and Union pay (as the first African Bank to sign such agreement). Dashen exclusively acquires and issues American Express cards in Ethiopia,

Moreover, the website further describes that the Bank is in partnership with Moneta technologies S.C, and has unveiled a ground breaking mobile financial services platform dubbed AMOLE on July 2018.

1.4 Statement of the Problem

Under the umbrella of Interest Free Finance (Islamic Finance), Interest Free Banking has different names throughout the world. For instance, it has been called “Non Interest Banking” in Nigeria. Since the Business is believed to participate in taking operational risks and impart depositors and borrowers some involvement in the administration of the fund, Turkey, Kenya and Some part of North Africa labelled it as “participatory Banking”. It has also known as Ethical banking, social Banking and Alternative Banking in some parts of the world. However, it is commonly known as

“Islamic Banking” in major parts of the world. The business mainly targets those customers who do not want interest based banking transactions for religious or other reasons (Adem, 2016)

Aurakzai (2015) notes it is the aftermath of 2007/2008 financial crises that gave Interest Free Banking (IFB) to grow in an exponential rate and flourish all over the world.

In the words of Mirakhor (2012), Islamic finance has experienced a remarkable growth in the last few decades and has been considered as a possible alternative to the conventional banking system.

Its growth in Africa also is very encouraging. Since 2014, Islamic finance is expanding rapidly across Africa with \$2.3 billion African sukuk, or Islamic bond, issuance, providing new funding sources for sovereigns and financial institutions ...According to the report, despite the growth, African sukuk make up just 0.5 percent of global sukuk (Majekodunmi, 2018)

The African countries are leveraged their economic growth and benefited from the field. Ever since the inauguration of Islamic financing in Kenya in 2008 or thereabouts, Islamic banking has seen a speedy intensification in a comparatively small period of time. (Bilal, 2013)

Bilal (2013) further point out the total assets of the banking industry were KES 951 billion (US\$10.78 billion) in 2007. Today, the total assets are KES 2.3 trillion (US\$26.08 billion) which indicates an increase of 241%, according to the Central Bank of Kenya (CBK). This demonstrates that the banking industry is playing a major role in the economy of Kenya.

The IFB business introduced to our country with the issuance of National Bank of Ethiopia Directive number 592/2008. Some African Countries started the business with same period. But the growth demonstrated in Ethiopia is not as good as these countries. Ethiopia should be at the forefront of the growth of IFB banking. However, when compared to other African countries, Ethiopia in fact far behind to make the progress it could have.

Even though there are a number of concerted efforts conducted to exploit the industry globally, comprehensive effort has not yet been done to tackle the challenges of interest free banking resides in Ethiopia. Dr. Abdela Seid on his speech held on the first Interest Free Banking Summit held here in Ethiopia on October 28, 2018 stresses that more as the subject is not explored more.

Therefore, this study will try to fill the gap by exploring the major problems confronted interest free banking in Ethiopia.

1.5 Basic Research Question

The problem addressed in the study was to find the major internal and external challenges faced by IFB business in general. In lieu of with this, the study was conducted to answer the following specific question.

- ✓ What are the major hurdles faced by Interest free banking with respect of institutional as well as country level?

- ✓ What are the major stakeholders responsible to take action for the progress of interest free banking service?

1.6 Objective of the study

The study has the following general and specific objectives:

1.6.1 General Objective

The aim of this study was to draw conclusions and to provide insight on the major challenges faced by IFB business. Conducting an exploratory research on the challenges of IFB business is the purpose of the research.

1.6.2 Specific Objectives

This study specifically strived to achieve the following special objectives:

- ✓ To find out what are the major challenges faced by the Interest Free Banking
- ✓ To recommend the best solution to alleviate on issues holds up for progress
- ✓ To aware leaders and other interested stakeholders in advance the main challenges of IFB business as well as the related recommendations to ease their fears.

1.7 Definition of terms

For the purpose of this study, unless the context provides otherwise:

“**Fiqh**” means knowledge of the legal rule pertaining to conduct, which has been derived from specific evidence in the Shari’ ah

“**Fatwa**” means a legal ruling on an issue of religious importance

“**Muammalat**” means affairs which have a monetary aspect, such as, business debt, contracts, service and labour.

“Interest” means any premium charged on money borrowed is tantamount to interest irrespective of the amount paid. Hence, it is prohibited because it concentrates wealth and nurture inequality through exploitation.

“Shari’ ah” means Islamic law and jurisprudence as expounded by authoritative sources; in the context of this policy, it is construed by reference to pertinent Qur’anic ordinances and applicable rules in Islamic jurisprudence or business transactions;

“Sukuk” means an Islamic financial certificate, similar to a bond in Western finance that complies with Shari’ ah.

1.8 Significance of the study

This study examined all of key elements of Interest free banking challenges; it will offer a larger picture of the external and internal obstacles that hinder the industry not to flourish as expected as compared with the neighbouring peer countries’.

Contributing literature describing interest free banking hurdles along with methods to improve the efficiency of the industry believed to lead the desired state.

And finally, the researcher has a firm believe that the study will be used as an input to inform various stakeholders for further study.

1.9 Delimitation/Scope of the study

It will be more reliable to make wide study in all Ethiopian commercial bank that provide interest free banking window along with their conventional banking services (there are eleven interest free banking windows over all in Ethiopia).

However, because of lack of sufficient time, financial constraints and limited human resource, the researcher confronted to limit the study to explore the challenges of Interest free banking only on Dashen Bank S.C.

1.10 Organization of the Study

The aim of the study is to explore the main challenges of Interest Free Banking window in Ethiopia and organized as follows. Chapter One covers background of the study, statement of the problem, research objectives, research question, definition of terms, significance of the study, limitations and scope of the study. Chapter two contain a literature review informing the reader of what is already known in this area of study. Chapter three describes the data, identifies the sources and explains the methodology which was employed in the study. results of the different methods used and an analysis of the results are presented in chapter four. This is followed by the conclusion and recommendations in chapter five.

Chapter Two: Literature Review

2.1. Introduction

Cognizant of the challenges some financially excluded customers are facing in terms of accessing financial services, in 2008 the Ethiopian government issues Proclamation No.: 592/2008 that authorize NBE to issue a directive to regulate banking business related to non-interest bearing deposit mobilization and fund utilization in the country. Following the proclamation, NBE issue two directives namely Directive Number SBB/51/2011 and 79/2019 in the year 2011 and 2019 respectively. The Directives allow for commercial Banks to accept deposits from and offer credit facilities to the target beneficiaries. In the year 2011 and following years a number of commercial Banks launched IFB window service have been established in Ethiopia that caters the financial needs of IFB customers. A report by NBE (2020) revealed that currently there are eleven commercial banks have got a license for IFB window service.

Despite the vital role IFB are playing in easing the Banking need and promoting access to finance in Ethiopia, the sector is facing various constraints.

The IF Banking industry has been growing rapidly around the world and now covers a broad range of product types: Musharakah (a joint enterprise in which all the partners share the profit or loss of the joint venture), Mudarabah (a partnership or trust financing contract where the banks give money to working partner for investing in a commercial enterprise), Murabaha (a sales contract where the buyer and seller agree on the profit or cost-plus price for the items being sold), Wadiah (bank or custodian acts a trustee and take care of the fund without any financial return for the customer) and Ijara (leasing) are among the most common services of IF banks.

2.2. What is Interest Free Finance

The IF financial system is similar to the conventional financial system in terms of products and services, but its operations are primarily guided by a set of moral and ethical principles that define what is considered morally 'right,' implying actions and transactions that benefit the public good, and 'wrong,' implying actions and transactions that are likely to harm the public good. (IIBI, 2021)

Simply describing the Islamic financial system as "interest-free" does not give a complete picture of the system and might lead to misunderstanding. While barring the receipt and payment of interest is at the heart of the system, it is backed up by other Islamic doctrines that promote individual rights and responsibilities, property rights, equitable wealth distribution, risk-sharing, obligation fulfilment, and contract sanctity. The Islamic financial system encompasses insurance, capital formation, capital markets, and other sorts of financial intermediation, and recommends that, in addition to sensible and effective regulations, moral and ethical features in the regulatory framework are also required. (IIBI, 2021)

Interest Free finance is certainly not an Islamist phenomenon and has no political agenda of any kind at all. For providers of IF finance services (which include the likes of Dashen Bank S.C. under the Brand Name "Sharik" IFB window) Interest Free Finance is nothing but a business opportunity.

2.3. IF finance and IF Banking

IF Banking is a type of financial system in which services, instruments, and transactions are carried out in accordance with IF principles, the tendency is for Muslims, Christians, Jews and traditionalists to ensure the finances are interest free (Shittu,2012), but not necessarily to mean without financial return. In fact, interest free banking is only an aspect of finances which Islam encourages and prefers to any other principle i.e. interest based transactions.

On the one hand, the contemporary banking system has its origins in the west, which once controlled the global financial industry and is based on the concept of "interest." (Shittu 2012). Interest free Banking, on the other hand, is an emerging variant of the conventional banking business and the intermediary role of the IFB is based on the cardinal principle of "interest free" and can be modelled in Full-fledged, subsidiary and window models.

As part and parcel of the global economic, cultural and political community, Ethiopia has embraced the developments on interest free banking. In lieu of such understanding and responding to the increasingly strong demand for interest free

banking products, the National Bank of Ethiopia had issued Directives number SBB/51/2011, which came in to force as of 1st October 2011. The directives allowed domestic banks to offer interest free banking on window service modality, i.e., as an integral part of their conventional banking services.

Another recent proclamation, which removed the restrictions on Banks to offer interest free banking services, effectively allowed the introduction and operation of full-fledged interest free banking. Subsequently, banks are on the verge of opening a dedicated IFB branches that provide only IFB products and services. In addition, a number of banks are under formation to offer a full-fledged IFB that further intensify and extend the existing competition in the market to the IFB business.

2.4. Interest/usury

It is indeed very necessary to highlight the difference and similarity of interest and usury.

The Christian viewpoint on usury dates from 325 C.E. The Council of Nicea, the Church's first general council, set the first Catholic Church position at the time, prohibiting the charging of interest on loans (Homer and Sylla 1991). Centuries later, the Hadriana (about 750 C.E.), the Nynweger Capitulary (about 806 C.E.), and the Paris Synod (about 829 C.E.) strengthened the prohibition.

Because of the tangible character of money, a money loan must be a sale of money for which repayment equals full recompense. As a result, charging for the usage of money as well as for the sale and then demanding repayment with interest is a kind of fraud. Aquinas did believe that making money from a loan was legitimate provided the lender shared in the borrower's risk (Jones, 1989).

However, the prohibition of usury was first broken in 1545, when England permitted charging interest up to a maximum of 10%. The term usury was then only applied to interest rates that were excessive or unconscionable. Around the same time, John Calvin defied Church tradition by claiming that money was not sterile and incapable of producing its own fruit (Lewison 1999). Calvin (1509-1564) is widely regarded as the "Father" of modern banking. He devised a method for the Reformist (Protestant)

Church to allow various forms of interest to be charged. While his method of distinguishing the two nouns differs from the major focus of this work, the author considers it intriguing and worthwhile to read. He popularized the modern approach toward interest and is widely credited with inventing the modern interest theory. In his opinion, there is a distinction between the meanings of usury and interest, and that usury is the worst kind and should be prohibited, whilst interest should be allowed but regulated.

Ethiopian Civil code, on one hand, laid down articles to govern Interest and usury. The main articles to refer are 1751, 1803 and 2478. The articles stated as follows:

- ✓ Article 1751- “the rate of interest shall be of nine per cent per annum where interest is due and the rate has not been fixed”.
- ✓ Article 1803
 - i. Where the debtor owes a money debt and he is in default, he shall pay interest for default at the rate fixed by law (article 1751) notwithstanding that the contract fixes a lower rate in respect of interest to be paid before the debt is due.
 - ii. Where a higher rate of interest is fixed in the contract, such interest shall be due in lieu of interest under sub article (i).
- ✓ Article 2479
 - i. The parties may not stipulate a rate of interest exceeding twelve per cent per annum.
 - ii. Where it has been agreed that the loan will bear interest but a higher rate has not been fixed in writing, the borrower shall owe interest at the rate of nine per cent per annum.
 - iii. The borrower shall also owe interest at the rate of nine per cent per annum, where a rate exceeding twelve per cent per annum has been agreed in writing.

In lieu of the forgoing civil code article, it can be concluded that interest rate more than twelve percent is considered as usury or illegal interest rate,

However, Islamic position does not distinguish between interest and usury. The term usually used to indicate Interest/usury is commonly known as Riba. A contemporary scholar, Nabil (1992) has defined it as unlawful gain derived from the quantitative inequality of the counter value in any transaction purporting to affect the exchange of two or more species which belong to the same genus and are governed by the same efficient cause. Riba further categorized in to two: Riba al nasia and Riba al fadle.

According to Al Kasani (1997), Riba al fadle (Riba by way of excess) is the excess revealed through Shari' ah criterion stipulated in one of the two counter – value, in transaction of exchange.

The Shari' ah criterion in this definition refers to weight or measure of capacity or count. Thus if two persons were exchanging wheat with each other, the quantity must be equal on both sides; if there is excess on one side in terms of weight or measurement.

Riba al Nasia (Riba of delay), on the other hand, is Riba by way of deferment of completion of an exchange. It takes place when articles of the same genera or different genera, whether measured or weighted, are exchanged with deferment on one side, whether or not there is real excess in favour of either side. Thus, if 5 kg gold is exchanged for 5 kg gold with a delay of one year, it will amount to riba al nasia because it has arisen from a period of delay. (Al Kasani, 1997)

2.5. Relationship between IFB customers and IF Banking

Unlike conventional bank that has creditor/borrower relationship with its customers, an IFB has more relation scope than its counterparty. The three major relationship IFB Bank has with its depositors as pointed out by Qaseem (2012) are the following

- ✓ **IFB as a service provider or Agent:** An IFB provides various banking services such as remittance of funds, lockers; safe keeping of funds, ATM

services, mobile banking services, etc., to its clients against agreed fees and commissions. It carries out such services in its capacity as a service provider or an agent against a fee or commission. But unlike conventional banks, it provides only ethical banking services against agreed upon fees and commissions.

- ✓ **IFB as a Fund Manager:** Another role of an IFB is that it manages, against a fee or a share in the profit, the funds of its depositors. It may receive investment deposits on the basis of the following three contracts:
 - i. **Investment account:** the IFB equivalent to saving account or time deposit is commonly referred to as Investment accounts. There are two types of investment accounts: unrestricted and restricted investment accounts. Here, the IFB manages funds against an expected reward which is an agreed share in the profit to be generated from deployment of those funds, and pool these funds together for investment in the pool.
 - ii. **Wakala:** the IFB will receive a lump sum amount, or a percentage of the invested amount, as its agency fee. As agent, the IFB is not responsible for any loss of the invested amount unless the loss is attributable to its negligence, misconduct or breach of agency contract.
 - iii. **Musharaka:** the IFB shall become the managing partner with one or more depositors in specific investments or transactions.
- ✓ **IFB as a safe keeper or borrower:** an IFB may accept deposits from various clients who do not want to share any risk on the basis of safe keeping or borrower in which the customers are not entitled for any financial return.

Qaseem (2012) further elaborated that the deposit mobilization concept in IFB states that the person who deposits money must choose between sharing profits or keeping

his money safe. If the consumer wants to keep his money safe, he must waive any claim to any additional funds above the principle amount. However, the sum of his initial contribution will be safeguarded and guaranteed. If the purpose of depositing money is to share profits, the customer can claim a percentage of the gains actually produced and must also be willing to share losses if the bank suffers a loss.

Therefore, anyone can conclude from the above that exclusion of interest from financial activities does not mean that the financier cannot earn a financial reward or return.

The author further mentioned the following four relationships that IFB has with its financing customers:

- ✓ **IFB as a trade partner:** – in this case financing shall involve asset at the back of the transaction. IFB provides cost plus mark up, market price less discount, advance payment and manufacturing financing that involves asset in behind.
- ✓ **IFB as a leasing partner:** – an IFB may conclude a leasing contract whereby the IFB transfers its usufruct to the customer for an agreed period, at an agreed consideration.
- ✓ **IFB as a partnership:** – the unique features of an IFB financing is that the product is believed the spirit of IFB financing for involving real profit and loss sharing. In such relationship, an IFB may play a role as passive or active partner
- ✓ **IFB as a benevolent loan provider (Creditor/borrower relationship like conventional banking):** sometimes an IFB may grant a beautiful loan without demanding any financial return from the customers.

2.6. Fundamentals issues of IFB Service

There are two fundamental issues in IFB window, i.e., prohibitions and legitimate. Among the proscriptions as defined by Minhas are presented as follows:

Interest (RIBA): as defined by Minhas (2014) Literally Riba Means increase, addition, and augmentation. The technical meaning of Riba is an increase in the principal, stipulated in loan transaction. So anything chargeable in addition to the principal amount as a contractual obligation falls under the purview of Riba.

Uncertainty (Gharar): Literally the Arabic word Gharar conveys the meaning of indeterminacy, speculation, hazard and risk. as a technical term it is applied to uncertainty about the ultimate outcome of a contract, which may lead to dispute and litigation. A contract is presumed to suffer from Gharar if it is about:

- ✓ An occurrence about which the parties are unaware whether such an event will take place or not;
- ✓ A thing that is not within the knowledge of the parties;
- ✓ A thing about which it is not known whether it exists or not;
- ✓ A thing whose acquisition is in doubt; and
- ✓ A thing whose quantum is unknown

Therefore, contracts must be drafted and transacted as clearly as possible to avoid any Gharar in the quantity, quality, or existence of the subject matter of a contract.

Gambling (Qimar) and Games of chance (Maysir):

Qimar includes every form of gain or money the acquisition of which depends purely on luck and chance. As opposed to others equally eligible, one may acquire income as a result of lottery or lucky draws. It also includes any receipt of money, benefit or usufruct that is at the cost of the other party or parties having equal entitlement to that money or benefit (Ghazi, 1988)

Maysir literally means getting something too easily or getting a profit without working for it. The form most familiar to the Arabs was gambling by casting lots by means of arrows on the principles of lottery. The arrows were marked and served the same purpose as a modern lottery ticket. An item e.g. the carcass of slathered abnormal was divided into un equal parts. The marked arrows were then drawn from a bag. Those who drew blank arrows got nothing while other arrows indicated prizes big or

small. Whether one got a big share or a small share or nothing, depend on pure luck. Dicing and wagering are highly held to be within the definition of gambling and maysir (Ali, 1983)

Legality of subject matter

According to Mansury (2005) the commodity, service or performance must not include things prohibited like wine, pork, intoxicants, and prostitution. It is forbidden to acquire, sale or transfer through contract anything unlawful goods and services. Since adultery, obscenity and immorality are prohibited, any contract or transaction that entails these or promotes them in any way is forbidden. From this it is established that the subject matter of a contract must be such in which transactions are legally permissible. The list of things prohibited includes wine, flesh of swine, blood or animals, which have died naturally.

The legality of subject matter further requires that the commodity should be owned by someone. Thus public property is excluded and cannot be the subject matter of a contract, legality of subject matter also requires that there should be no encumbrance or right attached to it. An example in this regard is sale of mortgaged property to which the rights of the creditor/mortgagee are linked. (Mansury 2005)

This includes sales of pork, alcohol, pornography films and photographs, services also cover hosting prostitutes, and act of prostitution and related matters are within the ambit of illegitimate business transactions. (Mansury 2005)

Ethical Dealings

Another fundamental issue as stated by Shittu (2014) is the ethical value with which Muslims have a moral obligation to conduct their business activities, as well as their personal life, in accordance with the requirements of Shari' ah. Those requirements include moral values and business ethics.

Indeed, the adherents of Islam, Christianity and Judaism should be fair, honest, humble and just towards one another. It is a duty for them to earn a living, support

their families, and give charity to those less fortunate. However, in their business activities, it is a moral obligation to fulfil their promises and commitments, pay their liabilities as and when due.

2.7. Differences between IFB and Conventional Banking

In order to gain a better understanding of IFB model, there is a need to understand the primary differentiating features between IFB and conventional bank as shown in the table (Ansari, Bakir and Noor, 2017).

Table 2. 1: Difference between Conventional and Islamic Banking

IF Banking	Conventional Banking
Money is not a commodity; nevertheless, it is used as a medium of exchange and store of value. Therefore, neither it can be sold nor rented out at value greater than its face value	Money is a commodity and is also a medium of exchange and store of value, therefore it can be sold at a price higher than its face value and it can also be rented out.
Reward should be a consequence of undertaking risk. It revolves around risk taking and risk sharing	Conventional banking practice are concerned with the elimination/transfer of risk
It promotes risk sharing b/n the provider of capital (investor) and the user of funds	The investor is assured of a predetermined rate of return with nil/negligible risk
Profit on trade of goods or service charge is the basis of earning profit	Time value is the basis for charging interest on capital
The status of IFB in relation to clients is that of partners, investors and trader, buyer as well as seller, as well as lessor and lessee	The status of conventional bank is that of creditors and debtors
IFB finance are free from uncertainty transactions. They ensure mutual benefit, covering and spreading risk of	Economic activities do involve speculative elements

both counterparties to the contract by making each one's obligations clear at the outset	
IFB do not provide any assistance and strictly discourage the production of goods and services which are against the principle of IFB. Such as gambling, alcohol...	Do not discourage the production of goods and service which are harmful in general to the society and individual
While disbursing funds under Murabaha, Salam and Istisna contracts, the execution of agreement for the exchange of goods and services is required	While disbursing cash finance, running finance or working capital finance, no agreement for exchange of goods and services is made
It tends to create link with the real sector of the economic system by using trade related activities. Since money is linked with real assets, it contributes directly to economic development	Use money as a commodity which is supposed to lead to inflation and economic imbalance

Source: Adapted from Iyad (2015)

2.8. Interest Free Financing in Ethiopia

With one-third of the population (around 35 million) recognized as Muslims (CIA World Fact Book, 2020), Ethiopia is one of the biggest Muslim populous nation in Africa. Due to this, Ethiopia is an ideal target for the IF Banking and Financing industry. Though in its initial stage, Ethiopia begins Islamic banking and financing, which is also referred to as interest-free banking, after the Banking Business Proclamation authorizing the establishment of interest-free banking in 2008.

In Ethiopia, access to finance is usually very low. According to Hersi (2018), only 14% of the adult population has access to formal credit and savings products. Until very recently, there were no FIs providing interest-free banking and financing services to the large population. Up until this time, there is no full-fledge Islamic financial institution. Currently, the interest-free banking scheme is operationalized at

a separate window at eleven of the conventional banks, and over ETB 80 Billion has been mobilized (For further information, please refer Annex 1.)

Whilst progress is being made, there are several challenges that need to be addressed in order to enable more penetration of the service in the country and to unlock the potential of this growing industry., however the challenges may well be transitory in nature and typical of any new emerging industry, in reality the prospects for IFB in Ethiopia overshadow the challenges and the terrain seems naturally conducive since there is high demand for IF banking service, both amongst potential customers and investors.

2.9. Empirical Evidences on the Challenges of IFB window operation

Existing evidence on IFB has shown that there are some challenges influencing the practicability and sustainability of IFB window. For instance, Abdul Rahman & Dean (2013) point to high cost and prices of financial product, poor marketing strategies, financial literacy of products, geographical constraints typically among include lack of accessibility to rural areas and weak law enforcement. According to the authors, the challenges fall into the following categories which includes lack of uniform IFB window modality, lack of robust Shari' ah governance framework, Central Shari' ah supervisor and dispute resolution, marketing and product development. The challenges may also further cover lack of ownership and cannibalization with conventional counterpart, limitation of core banking system, commingling of IFB fund.

On the other hand, according to Bello & Abubakar (2014) the problems related to IFB are categorized into institutional and operational challenges. Operational problems comprise of inefficient financial innovation, lack of Shari' ah- complement packages, social and religious differences, lack of sufficient competition and awareness as well as lack of qualified manpower. While, institutional challenges embrace insufficient legal framework, poor supervision, unsuitable institutional framework for equity.

2.9.1. Absence of uniform window modality

According to Global Islamic Finance Report or GIFR (2014), an IFB window by definition can be a department or a division or even a separate finance company set up by a conventional financial institution which offers IF products and services to customers who prefer IF finance over conventional finance.

The report further elaborated as that while every Muslim dominated jurisdiction has witnessed Islamic banking and Islamic windows; there is no uniformity of thinking on their operational model.

The concept of an Islamic window within a conventional bank goes back some 20 years; however, there is relatively little written on this concept and the fundamentals which should be considered carefully by conventional institutions. There is also an absence of guidelines issued by the State regulator on this subject matter. Perhaps the most advanced and evolved model of the Islamic window is found in Malaysia where both law makers and regulators have proactively supported the Islamic banking and finance (IBF) industry. (GIFR, 2014)

2.9.2. Shari' ah Governance

As pointed out by Saba (2017), Shari' ah compliance is the backbone of IFI. It not only gives legitimacy to the practices of IFB, but also boosts the confidence of the shareholders and the public that all the practices and activities are in compliance with Shari' ah at all times. The existence of non-Shari' ah compliant element would not just affect the confidence of the public but might also expose IFIs to fiduciary and reputational risks. Compliance with the Shari' ah principles will be achieved through having a proper Shari' ah governance framework in placed.

Despite the fact that many guidelines are provided on Shari' ah governance, each country has their own coverage and differences based on specific countries culture or institution scope of enforcement and objectives. As a result, there are differences in regulations and guidelines for governance model and its disclosure between countries. This makes it difficult for Islamic banks to have a uniform benchmark for

their practices. Many governments and regulatory bodies have been continuously exerting efforts to strengthen the IF finance industry. (Saba, 2017)

She further recognized that as the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) have issued a number of governance and auditing standards and guidelines for international consumption.

AAOIFI recently revamped its Shari' ah Governance framework and added a detailed standard with the importance Shari' ah supervisory board, I Shari' ah review and Compliance, independent External Shari' ah Audit and Central/National Shari' ah board.

Shafique (2015) on one hand argued that Shari' ah is an extra layer in overall operations or governance of IFB. Every jurisdiction has its own customized model for ensuring Shari' ah compliance. However, there are broadly two levels in every model; one at institutional level and second at regulatory/supervisory front.

Shari' ah Advisory/Committee

There is a wide scope of role of Shari' ah scholars/boards have a wide role ranging from involvement in establishment of IFIs, developing products and ensuring Shari' ah compliance of processes, setting up of Shari' ah compliant policies and regulations, to harmonize with international and local standards and adoption of global best practices along with parting training to the staff. (Shafique, 2015).

Shari' ah Advisor at regulator/Central Supervisory level

Regulators of IFIs bear huge burden of responsibilities of guaranteeing Shari' ah compliance by IFIs institutions. This necessitates the setting up of Shari' ah advisory board at the regulator/central supervisory level. This should ensure development of legal and regulatory framework for smooth functioning of interest free Finance, developing products and structures for government or regulators' incentive schemes for industry and Shari' ah supervision of institutions offering Interest Free finance.

The central Shari' ah advisory board should also work as final authority in case of any disagreement between Shari' ah department and management of an IFIs. Along Shari' ah scholars, Shari' ah board/committee may also have members who are not specialized in fiqh al muamalat but have got expertise in other aspects of IF finance like legal, accounting and taxation etc. the fatwa and rulings of the sharia supervisory board should be binding on the IFBs. (Shafique, 2015)

2.9.3. Lack of IF Dispute resolution system

Many IFB transactions are governed by English Law or the law of another country, instead of Shari' ah law. Shari' ah is a set of moral and religious principles rather than a codified body of laws... due to the diverse backgrounds of the parties involved, the specialist nature of the agreements and the potential variety of legal jurisdictions in play, there may be considerable benefits in having an authoritative common platform to resolve dispute as they arise in a manner that is guided by Shari' ah within a modern commercial context. (Khan, 2012)

Dispute resolution methods

When things go wrong in IFB contracts, disputes can be resolved by litigation, arbitration and mediation.

Litigation

Litigation is the most well-known method of determining disputes. Amongst some entities working in Islamic finance there is scepticism towards alternative forms of dispute resolution. There are two agreements in this regard. The first one is that it was held that a contract can only have one governing law and that parties to contract can only agree to adopt the law of a country as governing law of a contract. Therefore, according to English law, as Shari' ah law is non-national system of law. It is not capable of being the governing law of a contract. (Khan, 2012)

An alternative argument that was made to the English court of appeal was that, with English law being the governing law of the contract, it is possible to incorporate general Shari' ah principles as terms of the contract. (Khan, 2012)

In short the English courts are concerned:

1. The governing law of contract has to be either English law or the law of the country, therefore, Shari' ah law cannot be the governing law of a contract
2. It may be possible to incorporate as terms of the contract certain principles of Shari' ah law, provided there is certainty as to what is being incorporated.
3. Whilst there has been a tendency to favor court litigation as means of resolving disputes in IF finance, the English courts have at times encountered difficulties in dealing with contracts where the parties have, at least to a certain extent, sought to have their dispute resolved in accordance with Shari' ah or other non-national laws or principles.

Arbitration

Arbitration is non court alternative methods of resolving disputes, where a neutral, independent arbitrator or panel of arbitrators, known as a tribunal, is appointed by the parties to make a binding decision, known as award, from which there are very limited grounds of challenge. Arbitration may be either administered (where the arbitration is conducted under the auspices of one of several arbitral institutions) or non-administered/ad hoc (where the parties agree between themselves the rules that will apply to the arbitration, without the involvement of an institution for arbitration. (Khan, 2012)

Arbitration has been seen by many as a panacea to the problem of accommodating the Shari' ah into a non-Shari' ah framework. (Saba, 2017)

Mediation

Mediation is another important method of alternative dispute resolution. Mediation is a flexible process conducted confidentially in which a neutral person (y=the

mediator) actively assists parties in working towards a negotiated agreement of a dispute or difference. The parties are in ultimate control of the decision to settle and the term any resolution. Mediation can be used alongside litigation or arbitration at any stage. (Khan, 2012)

Legal pluralism

Another way of resolving IFB disputes is through legal pluralism. The term as defined by GIFR (2011) is a system where multiple legal systems can coexist together as a basic element of all legal systems. According to legal scholar John Griffiths, legal centralism- the notion that there is just one kind of law, namely state-enacted legislation – is a myth, and legal diversity can be found in all aspects of life. A legal system is pluralistic when the sovereign tolerates the application of different legal systems for different groups.

2.9.4. Lack of ownership and Cannibalization against Conventional wing

IFB windows should not be set up simply because of market trends or due to pressures of stakeholders as the model requires a concerted effort by everyone in the conventional bank, not just the IFB banking personnel to set up the operations. (GIFR, 2014)

Hence, when stakeholders of the bank have decided to establish an IFB window, senior management across the bank needs to take ownership to deliver the business successfully. This means that the approved strategy for the IFB window must be layered with key initiatives underpinned by well-defined objectives which should be modelled to target a certain market share in the segments it would like to penetrate against measurable revenues/expenses expectations. The success of the IFB window is in buying in of the initiative by the management of the conventional bank and each one of them taking ownership for its successful launch and continuing support. The objectives must be converted into measurable targets both qualitative and quantitative. (GIFR, 2012)

Each target needs to have well defined processes duly supported by all the functionalities under service level agreements and turnaround time.

The IFB window must not compete internally with the existing conventional franchise. It must be seen as supplementing the existing business of the conventional bank through servicing existing customers who may elect to choose IFB banking, or it can target new customers without cannibalization. (GIFR, 2012)

2.9.5. IFB Core Banking System and segregation of IFB Fund

Ahmed (2014) defined core banking system as simply a giant system that controls and runs all or most of a bank's electronic services. Most conventional banks are using the core banking system to run their business activities. For these banks, opening an Islamic banking window is not an easy task; it requires many customisations to the conventional core banking system, and these customisations are making the system difficult to support, which thus limits Islamic banking activities. Conventional banks seeking this option are required to maintain separate accounting books and reporting.

In this type of system, clients need to ensure that total segregation is established between conventional functionality and Islamic banking functionality, particularly in terms of coding, databases and interfaces. (Ahmed, 2014)

An Islamic banking core system needs to cover all of the banking activity at all levels (personal, commercial, corporate and treasury) with a profit distribution engine that allows for profit sharing based on predefined pools of capitals. The core system needs to comply with Shari' ah and The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) accounting standards. (Don, 2011)

Having a right IT platform, Shari' ah based Islamic banking architecture and experienced Islamic banking IT team is another critical success factor. The challenge is to create a parallel banking platform which seamlessly interfaces with the existing system of the conventional bank while maintaining a Chinese wall between the

Islamic and conventional accounts. This includes creating the Islamic business objectives, general ledgers, accounting codes for overall Islamic business segments, products and services accounting codes and booking methodology, product profitability measurements, account maintenance, etc., and how all of this is reflected in the system and produced in the management reports and financial statements.

The purpose is to make sure that Islamic funds, assets, liabilities and expenses are not comingled with the conventional books and could be separately audited by external auditors, approved by the SSB, and could also be presented to the regulatory examiner. One way of developing a Shari' ah compliant system is to work with the existing legacy system and the core banking platform which the conventional bank has and to modify this which requires more time and resources. The other option is to look at a latch-on Islamic system which can be fully integrated with the existing core banking system. A customer interface is on-line banking whether at retail or corporate banking level. A user friendly on-line banking system has become an essential tool for any banking institution, and this is also valid for the Islamic window model. On-line banking systems should allow customers to enquire, transact, instruct and get reports of their activities at all levels in addition to cash management solutions for corporate customers. The better approach is to have the ability to segregate customer-by-customer levels into two – conventional and Islamic with both reporting separate statements yet being reflected with the account manager for a customer profitability report. (Don, 2011)

The idea being that all hard income from Islamic businesses should be booked in one consolidated book. (Ahmed, 2014)

However, the sector is challenged for not employing an IFB core banking system with that interface with exiting conventional wing system, does not support real time distribution module, poor customer interface and not flexible with the changing trend of Shari' ah rules.

Table 2. 2 : Islamic core systems: new sales in 2009

Region	Location	Supplier	System	Total
Africa	Egypt	TCS Financial Solutions	Bancs	1
	Libya	Path Solutions	iMal	1
	Sudan	Path Solutions	iMal	2
	Tunisia	Temenos	T24	1
Africa Total				5
Asia Pacific	Hong Kong	Path Solutions	iMAL	1
	Indonesia	Temenos	T24	1
	Malaysia	Callataÿ & Wouters	Thaler	1
		Path Solutions	iMAL	2
		Thomson Reuters	K+TP	1
Asia Pacific Total				6
Central & South East Asia	Bangladesh	TCS Financial Solutions	Bancs	1
Central & South East Asia Total				1
Middle East	Bahrain	Temenos	T24	1
	Iran	SAB	SAB2i	1
	Iraq	Path Solutions	iMAL	1
	Kuwait	Misys Treasury and Capital Markets	OpicsPlus	1

		Path Solutions	iMAL	1
	Lebanon	Path Solutions	iMAL	2
	Qatar	Misys Treasury and Capital Markets	OpicsPlus	1
		TCS Financial Solutions	Bancs	1
	Saudi Arabia	Misys Treasury and Capital Markets	OpicsPlus	1
	UAE	Path Solutions	iMAL	2
	Yemen	Path Solutions	iMAL	1
Middle east Total				13
Grand Total				23

Source: IBS Intelligence

2.9.6. IFB Product Development constraints

IFB banking deposit and financial products are developed by banking product development teams, which necessarily means that the spirit of banking and finance is manifested in such products. The question arises as to whether Shari' ah requirements are followed in their true spirit when structuring them. Institutions offering Islamic financial services are meant to ensure that all Shari' ah requirements are observed in letter and spirit in developing and offering of Islamic financial products. (Aboozaid, 2012)

The main challenge here is that the inculcation of Shari' ah rules and principles in designing and structuring banking products is a new phenomenon. Notwithstanding this, the objective of IFB product development, so far, has been to structure products that offer similar economic returns as conventional products. This has at times attracted a lot of criticism from those who would like to see the letter and spirit of the classical nominate contracts upheld. Consequently, one viewpoint suggested by Abbozaid (2012) that the classical Shari' ah requirements cannot be fully observed in the context of contemporary banking and finance, and hence there is a need to come up with a new model for financial intermediation that should aim to remain independent of the current banking and financial sectors.

Abbozaid (2012) further pointed out that one way of implementing strict Shari' ah requirements of classical nominate Islamic contracts are to develop specialised institutions offering Islamic financial products independent of banks. Such specialised institutions must not be deposit-taking institutions in order to ensure that the bankers' mentality is kept out of the Islamic financial business. One implication of this proposed model is that Islamic financial institutions would not be able to achieve economies of scale as experienced by deposit –taking commercial banks.

2.9.7. IFB Marketing

Marketing is defined as "the act of planning and executing the development, pricing, promotion, and distribution of ideas, goods, and services to produce exchanges that satisfy individual and corporate objectives," according to the American Marketing Association.

Morphitou and Gibbs (2008) point out that Marketing aims to meet the needs of a customer's spiritual and physical well-being." The authors point out that the conventional system is self-serving; it advises purchasers to be cautious, whereas the Islamic system requires sellers to be cautious and reveal all relevant facts in a sales transaction.

Ethical marketing is similar to Islamic marketing. It is controlled by the Shari' ah, which establishes a set of ethical principles that regulate business and trade and places a strong focus on corporate social responsibility. Rather than maximizing profits, Islamic marketing emphasizes honesty, trust, equity, mercy, justice, transparency, and fairness to all parties involved in a transaction. (Ghoul, 2013)

Alom and Haque (2011) point out that conventional marketing is based on “wants”: the company wants profit and customers want satisfaction of their desires. In contrast, Islamic marketing is based on “needs” because Muslims are encouraged to consume moderately to satisfy needs rather than material wants, with a restriction that products and services should be Shari' ah compliant.

Elfakhani et al (2007) point out that in most countries there are no coherent standards of Islamic marketing regulations. High prices, deceptive practices, high pressure selling, shoddy or unsafe products, planned obsolescence, poor services to disadvantaged consumers, false wants and too much materialism, too few social goods, too much political power, and creating undue competition” are some of the criticisms by Kotler et al (2009) levelled at conventional marketing.” In contrast, Islamic marketing calls for a balanced relationship between the seller and the buyer, and between material and spiritual needs, while respecting the wellbeing of others and upholding ethical values of the Shari' ah. Fear of government prosecution restrains conventional corporations from activities such as false advertising or developing harmful products. Islamic marketing adds a second level of accountability which is before God.

Scrambles in IFB Marketing

Marketing a product or a service requires decisions about four marketing aspects: product, price, promotion and place. These are referred to as the marketing mix. In what follows, we review the marketing mix that is acceptable to the Shari' ah.

a. Product Characteristics

In terms of raw materials and processing, products must adhere to Shari' ah law and they must not be damaging to the body or mind. Furthermore, the sale transaction or contract must adhere to Shari' ah law. In an Islamic transaction the seller should be transparent by disclosing the product quality and revealing any defects to the buyer, whether obvious or hidden. (Ghoul, 2013)

Morphitou and Gibbs (2008) point out that the repackaging of a forbidden activity does not change its nature. For instance, in a murabaha transaction, an Islamic bank buys a property, marks up the price, sells it to a client for a higher price, and charges her/him to be paid in instalment payments. Critics of the Islamic finance industry claim that the mark up is actually Riba repackaged as the mark-up; however, the industry's defence is that both parties share the risk, unlike a conventional mortgage, and therefore this is not a valid criticism.

Jabaly et al (2013) criticise Islamic banks for acting as lenders rather than entrepreneurs, and point out that most banks have been focusing on non-PLS modes of financing such as murabaha, rather than PLS modes of financing (mudaraba and musharaka). Elfakhani et al (2007) note that Islamic banks during their formative years focused on short-term lending rather than supporting long-term profit sharing activities due to the "pressure" to perform and to offer viable alternatives to conventional products. The authors advise Islamic banks to "carry out their intended responsibilities to fund longer-term projects" now that they are more stable and mature.

According to Attallah and Ghoul (2011), some IF financial products "may be Shari' ah-compliant in form but not in substance, and may be consistent with the letter but not the spirit of Shari' ah." The same source argues against "Islamic" products which might involve indirect riba, deception, exposure to leverage, a high probability of a loss, risk amplification, speculation, and a delinkage with real economic activities. The authors opine that innovation is needed and encouraged in Islamic finance as long as Shari' ah spirit is preserved.

b. Price

Healthy competition is encouraged by Shari' ah, and this does not prohibit the determination of a fair price in the market place through the forces of demand and supply, as long as the interests of both the buyer and the seller are protected. Unjust prices are considered to be illicit and deceitful by Shari' ah. The Prophet Muhammad (Peace be upon him) is quoted as having said: "Those who cheat us, are not from us." The Shari' ah also prohibits price discrimination among people, such as between Muslims and non-Muslims, or between bargainers who are good at negotiating a lower price and non-bargainers who just pay the price set by the seller, since it is considered as a form of Riba. Any increase in a product's price should be justified by an increase in quality or quantity. Moreover, price fixing through collusion agreements is forbidden (haram). Wilson (2006) points out that overcharging customers through a monopoly is condemned in Islam.

Ghoul (2012) notes Islamic financial products have higher prices compared to equivalent conventional products. This has been referred to as the "Shari' ah premium" or "the cost of going to heaven. Examples of costs are the fees paid to Shari' ah scholars who issue certificates and fatwa of Shari' ah -compliance, as well as salaries of product "engineers" and lawyers. The high compensation which some Shari' ah scholars receive has been very controversial.

Haron and Azmi(2006) point out that the "majority of customers do not use religion as the main factor when establishing a relationship with Islamic banks... most customers still seek the highest return and lowest charges imposed when deciding which bank to place a deposit or obtain funding from."

To conclude, the pricing of Islamic financial products should be competitive with conventional products.

Husain (2007) quotes Dr. Akram Laldin, Chairman of the Shari' ah Advisory Committee of HSBC Amanah Malaysia: Scholars look at three basic areas when assessing the compliance of products: belief, legality and morality . . . products could fairly easily comply with Islamic law but it is more difficult to ascertain whether they comply with the morals of Islam. The price of a product may not be controversial

from a legal perspective but if the product costs more than an equivalent conventional product, it may not fulfil Islam's moral obligations of fairness and social equity.

b. Promotion

Shari' ah prohibits gharar which was defined by Kamali (1999) as fraud, adding that gharar in transactions has often been used in the sense of risk, uncertainty and hazard. In any contract, the vagueness or ignorance of the characteristics of the objects of the contract is considered to be deceitful.

The exaggeration in describing the traits of a product is prohibited by Shari' ah because it can be deceitful.

Promotion campaigns should be ethical and should not manipulate or pressure customers to submit to emotional factors, such as Shari' ah -sensitivity, fear, or sexual appeal. Rather reason, preference and need should justify the decision. Islam promotes moderation in everything, thus false statements that promote reckless spending and extravagance are forbidden.

Elfakhani et al (2007) note that Islamic banks typically count on word of mouth for promotion; they distribute flyers among attendees of mosques, Islamic educational institutions and Islamic centres. Jabaly et al (2013) point out that Islamic banks are now relying on conventional public relations agencies; this leads to problems in the reception and perception of marketing messages. They add that Islamic banks are restricted in their promotion activities because Shari' ah prohibits aggressive advertising.

d. Place (distribution)

Haron and Azmi(2006) point out that an ideal Islamic window should have the capability to replicate all existing conventional products and services (subject to SSB approval) and provide them with suitable distribution channel. Though IFB product structures typically makes legal and procedural documentation slightly lengthier and

cumbersome, the process, delivery channels and serviceability should match conventional products and services.

Western financial giants currently dominate the Islamic finance industry, but they are mainly interested in finding “another distribution channel for their products and services”; they save time and cost by re-engineering conventional products into ‘Islamic’ versions. (Haron and Azmi, 2006)

Chapter Three: Research Methodology

3.1. Introduction

The overall strategy, from the identification of the problem through the final plans for data collection and analysis, is referred to as research methodology. (Burns & Grove 2001).

The purpose of the research is to explore the major constraints of Interest Free Banking window operation in Ethiopia. In order to achieve this, an appropriate research design needs to be chosen. In this chapter, the research process and design which include the data collection method and instrument, data analysis, target population and sample, are discussed. According to Botes (1995), these are collectively referred to as research design. Justification is also given for the particular methods or strategies employed in this study.

3.2. Research design

According to Ghauri and Gironhaug, (2005) the basic difference between the three main classes of research designs are exploratory, descriptive and explanatory. The research can be exploratory when it deals with unknown problem, Descriptive when there is an awareness of the problem and explanatory when the problem is clearly defined.

As clearly indicated in the Research proposal, this study is an exploratory study that requires data gathering from Dashen Bank S.C. and uses qualitative research methods. Qualitative data will be collected from primary and secondary sources. Therefore, the study shall collect, analyse and synthesize qualitative (QUAL) data from both primary and secondary sources and make investigations on challenges. Shortly, the study will utilise qualitative method.

3.3. Target population

180 IFB employees, who were in their Managerial level, were targeted for participation as they had already been exposed to different IFB window operation.

3.4. Sampling

The study employed purposive sampling technique to identify the sample respondents. After identifying key informants through the help of Dashen Bank Human resource department, data have been gathered (from both primary and secondary sources), analysed and synthesized qualitatively, and made investigations.

3.5. Sampling criteria

For this study the inclusion criteria for the sample members were:

- The participant has to be assigned in IFB business
- The participants have to be in the managerial level post.
- The participants should have had exposure to IFB business

3.6. Validity and Reliability

Because of the delicate nature of the subjects discussed in the interviews, the researcher began the session by explaining the research method and assuring confidentiality. Furthermore, the researcher has provided an opportunity for respondents to ask any questions they may have before to the start of the interview. The respondents' comfort, trust, and openness are all improved as a result of this approach. It also aids in the creation of a more accurate and comprehensive picture of their experiences. The researcher did not use a third party to code the interviews.

The researcher employed certain practical techniques to eliminate bias, which is commonly associated with qualitative research. The initial step was to conduct a pilot

interview, which allowed the researcher to assess the questions' quality and comprehension. Maximum validity of the results was also sought by being clear, consistent, and precise throughout the interview, as well as in the transcription and interpretation of the findings.

3.7. Ethical consideration

As this research involves human participants, it was therefore necessary that the following ethical principles be adhered to:

- ✓ Individual respondents will never be identified in reporting survey findings; completely anonymous summaries, for example, in terms of tables and charts should be given. Respondents must be asked for their consent to participate in a survey, and their privacy and rights must be observed.

- ✓ The researcher exerts utmost effort for the respondents to know what the study will involve, how long it will take, and what will be done with the data.

Chapter Four: Data Analysis and Results

4.1. Introduction

To explore Interest Free Banking window service challenges in Ethiopia this survey was conducted on Dashen Bank S.C. This chapter presents the data analysis techniques of the study and findings obtained from the survey. A survey was conducted from head quarter and three District offices of Dashen bank S.C.

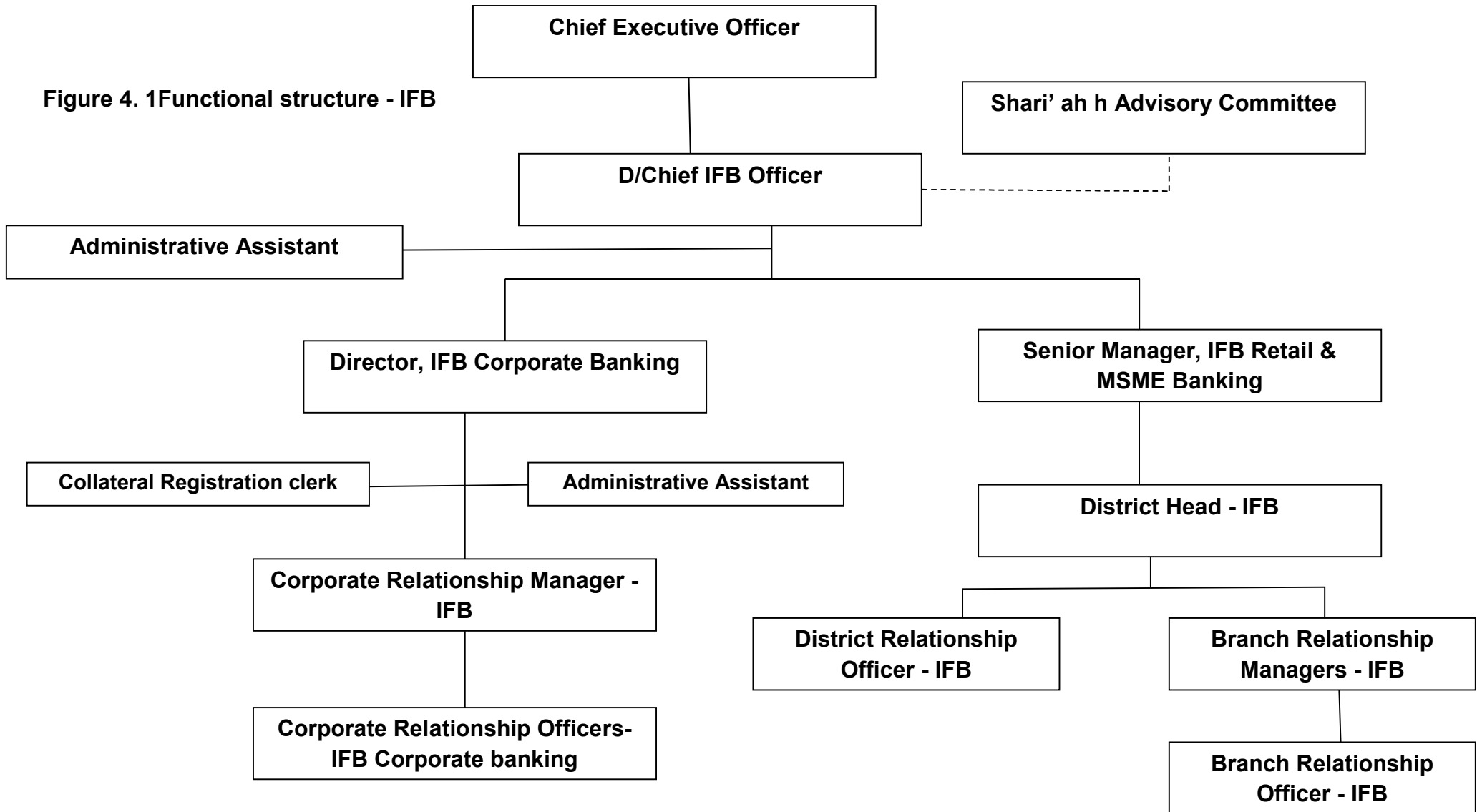
This part is divided into three main sections: The first section presents background of the study area; the second presents data analysis tools and techniques employed for the study and the last section focuses on the various findings obtained from the survey.

4.2. Background of the study area

Dashen Bank launched its fully Shari'ah compliant Interest Free Banking (IFB) windows operation on March 5, 2018 under a new brand called "Sharik". "Sharik" or "Sharikah" is the Arabic word which means "Sharing". According to the Bank, the main rationale for labelling its service as "sharik" is because the word is directly related with the spirit of Islamic Finance ethos. The service is available on all of its 437 Branches that are strategically scattered across the country. The Bank has also opened ten full-fledged IFB Branches in a bid to enhance our customers' experience.

The IFB business segment is structured to cater for Corporate, Retail and MSME clients as indicated in the following chart

Figure 4. 1Functional structure - IFB



The Bank apart from deployment of Shari'ah experts internally, it has appointed a five member Shari'ah Advisory Committee (SAC) to oversee the IFB business segment's Shari'ah Compliance and offer the Board, Management and Customers of the Bank's various advisory functions.

The Bank currently offers the following Deposit and Investment accounts to its customers that are based on established Shari'ah principles and contracts.

1. Wadiah Saving Account;
2. Qard Current Accounts;

The following Interest Free Financing products are also available at IFB unit to support the various economic sectors and financing needs of individuals.

1. Murabaha Working Capital Financing;
2. Murabaha Investment and Capital Goods Financing;
3. Murabaha Project Financing;
4. Murabaha Consumer Financing; and
5. Qard Financing.

The Bank's major activities for the month ended March 31, 2021 are summarized as follows:

- ✓ The total number of IFB account holders of the bank reached 241,392.
- ✓ The actual IFB deposit balance of the Bank as of March 31, 2021 reached Br. 3.992 Billion.
- ✓ The number of IFB financing clients stood at 341 that have a total 391 financing accounts.
- ✓ The total balance of outstanding IFB financings stood at Br. 1.73 Billion.
- ✓

4.3. Data Analysis

Data obtained from various primary and secondary sources were recorded, edited, structured, analyzed, evaluated, and presented in relation to research objectives in order for the study to be realized and completed successfully. Interviews were recorded in written notes and filled in a prepared format transcribed, and analyzed to discover the meaning units that emerged, as well as to explain the challenges of IFB window.

To allow a wide range of questions and associated issues to be examined, an in-depth, semi-structured, open-ended interview method was used. The interview questions were crafted using the research questions as a guide. Three data collection events occurred on a regular basis: the original recruitment, the actual interview, and the follow-up summary and exit interview. Warm-up questions about demographics and their function as a company leader kicked off the process, with the goal of guiding the series of inquiries from general to specific.

The average interview time per participant was 60 minutes. The interviews were conducted over the phone as well as in person. To prevent identity disclosure, unimportant portions of the description were also eliminated. Furthermore, all interviews were noted and transcribed with the consent of the interviewees.

During the data collecting phase, the researcher is the primary instrument for data collection and analysis for data clarification, summarize, and check with participants for accuracy of interpretation. Interview log was also used to keep track of what was observed during the interviews.

All transcripts were carefully studied in order to gain a feel of the overall message that the participant was aiming to convey. The researcher went over the transcripts again and again to find specific themes connected to the study. The transcripts were coded and recorded manually and independently by the researcher. A sample of transcripts was used to confirm that the researcher had captured everything correctly.

The researcher used a continuous method for reducing the data into manageable data portions, giving labels to each segment, and interpreting and providing meaning

to words, phrases, and remarks regarding the participants' opinions throughout the data analysis process.

4.4. Types and sources of data

In order to suggest applicable forwarded propositions to the benefits of both for Dashen IFB window unit and for Dashen Bank as well, it was essential to develop and use about four data collection instruments which were qualitative data in nature.

Specifically, the instruments employed to secure the required data include:

- ✓ In-depth Individual Interview with IFB window Deputy Chief officer,
- ✓ In-depth Individual Interview with IFB Senior Manager for Retail & MSME segment,
- ✓ In-depth Individual Interview with IFB Corporate Relationship Managers
- ✓ In-depth Individual Interview with IFB District Heads

Table 4. 1 Data collection instrument, data type, suggested sample size and analysis method

	Data collection instrument	Data type	Number of sample size
1	In depth interview with D/Chief IFB	Qualitative	1
2	In depth interview with senior managers		1
3	In depth interview with IFB District Heads		3
4	In depth interview with IFB Corporate relationship Managers		5

The respondent groups contacted for the study were the following

Table 4. 2 Responses obtained from different respondent groups

	Respondent group	Head office	Head office	West addis	east	South	north	wolayts	Dessie	Diredawa	Bahir dar	wolayta	Adama	Hawasa	Jimma	Total sample
5	In depth interview with D/Chief IFB		1													1
6	In depth interview with senior managers		1													1
8	In depth interview with IFB District Heads			1		1			1							3
	In depth interview with IFB Corporate relationship Managers		5													5
		Total	7	1		1			1							10

Secondary data was also gathered and used to describe and expand on the conceptual features of interest-free banking and financing services, as well as their applicability. Information was gathered from a variety of sources, including websites, books published by various authors, proclamations and NBE directives are consulted as well.

4.5. Findings

4.5.1. Shari' ah Governance

Deputy Chief IFB officer of Dashen Bank was asked what kind of shari' ah governance framework applied and how many shari' ah committee that Dashen Bank assigned for, thus he asserted that the bank already established Shari' ah advisory committee composed of five scholars. The Bank appointed full fledged Shari' ah advisory committee composed of five members (two of them holds Ph.D. in fiqh al muamalat, one hold master degree in Islamic finance from Malaysia and two of them holds B.A. degree in Shari' ah law).which directly report to the Board of Directors. The composition of the SAC is diverse backgrounds in terms of qualification, experience and knowledge.

The interviewee believes that all members have a respectable character and good conduct in terms of honesty, integrity, reputation and known with a big name in Muslim community.

According to the respondent, the guiding principles the Bank uses to recruit the Shari' ah advisory committee members are:

- Strong skills in the philosophy of Islamic law (Usul al-Fiqh), as he or she must know exactly the appropriate Fiqh methodologies for driving juristic opinions;
- Strong knowledge in Shari' ah and Islamic Finance; and
- Good knowledge of written Arabic, as he or she needs to be very conversant with the primary sources of Shari' ah.

He further indicated that Shari' ah advisory committee is responsible and accountable for all decisions, view and opinions related to Shari' ah matters. The SAC also perform an oversight role on Shari' ah matters related to the Bank's IFB business operations and activities. The committee is independent and act as consultative advisory body which approves all products and service, issue fatwas and approves financial statements of the Sharik unit. The committee is also engaged in meetings with bank's personnel, direct customer interaction, visiting banks various premises and Branches.

The officer further stresses that as they are tried to make the SAC Charter more broad and comprehensive through the inclusion of terms in connection with appointment and composition of SAC, fit and proper criteria for the members of the SAC, term of the SAC, diligence, conflict of interest and ground for disqualification of SAC members.

As regards to Shari' ah governance knowledge in Dashen Bank, almost all of other respondents knew that as the bank has five members of the SAC and other related units such as internal Shari' ah review, Shari' ah compliance and internal Shari' ah Audit.

From interview results, the researcher learned that Shari' ah advisory committee sometimes devote its time in examining financing files that can be managed by Shari' ah compliance or Shari' ah review officer and the major components of Shari' ah governance i.e. Shari' ah Compliance and Shari' ah review reports to units which hamper their independence and objectivity.

4.5.2. Lack of ownership

As learned from the data from interviews, almost all of the respondents agreed and said that lack of full ownership of the IFB service at Districts and Branches have been observed from the beginning. According to in depth interview made with deputy chief interest free officer, the researcher learned that this was one of the EMCs' focus areas in the last fiscal year. In the current fiscal year as well, a resolution was passed in the 24th annual Managers' Conference to ensure ownership of the IFB business across the board. According to him, the progress observed so far is not encouraging and needs immediate implementation of the recommended action plans. Moreover, he argued that Districts and Branches that are entrusted in executing all the Bank's core business segments, concerned Departments and work units should give due attention to the IFB business segment in their day-to-day activities and support the business as much as possible.

Interviewed Corporate Relationship Managers share the above observation whereas none of IFB district Heads do not recognize the presence of the issue in their district as well as Branches under their supervision.

Most of the discussants stressed that in order to promote IFB window to the potential customers so that they will expand and improve their Banking transactions; all the concerned stakeholders should work hand in hand in a collaborative manner

4.5.3. Public Awareness

The interviewed deputy chief IFB officer responded “the IFB business is first introduced at country level back in September 2013. Currently, only eleven banks are offering the service in a window model. It is expected that more banks would join the industry soon. We have recognized the need to create the necessary awareness among our existing clients and the general public. We have, thus, undertaken seven public seminars across regional towns including Addis Ababa in the early period of the service. Several workshops and training have also been conducted to create awareness about the IFB business and the available product and services among our staff. However, there is still a huge gap in the general public about the IFB product and service including few misconceptions such as IFB business is only for Muslims, the products availed in IFB window is without financial costs and return and IFB window model is not Shari’ ah compliant. Though it is not the sole responsibility of Dashen Bank to work on public awareness, we had planned to continue to hold public seminars and workshops across the county this fiscal year too. However, due to budget constraints and COVID-19 pandemic, the plan was not executed. “

About the need for awareness creation by the IFB, one of the discussants at Dessie IFB district noted that unless education (awareness creation) was given by the IFB, the opponents of IFB would discourage the potential customers not to partake in the business.

4.5.4. Non-Interest-Bearing Deposit Accounts

As the in-depth individual interviews showed, Dashen Bank was a pioneer in introducing deposit accounts that bear 0% interest in the name “non-interest bearing deposit account”, though not Shari’ ah compliant, a decade ago when there was no proper legal framework to support such services. After the introduction of the IFB window service, it was decided to halt opening such accounts at the conventional

wing and to migrate already opened account to the Sharik branded IFB window services by creating the necessary awareness among their customers and explaining the difference and value propositions of the two accounts. The decision was then backed by a joint study conducted by four departments. Furthermore, various communications were issued by IFB office and finally the Office of the CEO. Subsequent to the identification of the problem and inclusion of the matter in the Executive's focus area of the previous fiscal year, the Office of the CEO has issued a firm direction even to explore automatic conversion of the accounts to the IFB window. Besides, a resolution was passed in the 24th Annual Managers' Conference to fully convert the existing Non-Interest Bearing Accounts to IFB products. Unfortunately, the progress made so far by Districts and Branches is very slow. This has created unnecessary confusion among customers as they have at times mistaken it to IFB window service and raise various issues which should not have been raised in the first place had the accounts were migrated from the conventional books.

Senior Manager Retail & MSME in his response added that though the main objective of the IFB business is to keep existing customers who are opting to switch to IFB products, the effort made to switch noninterest bearing account customers to the newly Shari' ah compliant IFB product is very minimal.

One of IFB district head contacted through telephone acknowledged as there are some customers still served through noninterest deposit accounts. But they cited many reasons for the issue. They said that though branches and Districts are contacted to switch their accounts, some customers preferred to continue the non interest deposit accounts. Especially schools and other fee collection companies are not willing to have a new account which might create discomfort to their clients. Though there were some efforts to reach out huge number of non interest deposit account customers via their phone number, branches not able to get in touch with them.

4.5.5. The CORE Banking System

As the in-depth Deputy Chief interviews showed, the CORE banking system that Dashen Bank uses has an “Islamic Banking” module to cater for the IFB business segment. However, it lacks some basic features such as real time profit distribution, investment deposit accounts and financing products other than Murabaha financing to run an IFB business and rollout new products as needed. It has also become a source of irregularities and discrepancies observed in maintenance of the Books of Accounts of the IFB business and casted doubt on compliance of basic requirement of the regulatory body with regards to separating the funds of the IFB business from that of the conventional one. Efforts are underway to fine-tune the CORE banking system so that it caters to current and future need of the IFB business segment in the remaining periods of the system life.

From the interview responses, it can therefore be concluded that the limitation of the existing core banking is the major key area that need immediate attention by the Bank.

4.5.6. IFB Windows and Dedicated IFB Branches

Interview results from Senior Manager Retail & Micro, Small and Medium Enterprise (MSME) indicated the Bank’s branch network has reached 439 during the end of the third quarter of the fiscal year 2020/21. The provision of the IFB service is being rendered across 427 conventional branches through dedicated windows and 11 fully-fledged dedicated IFB branches.

Ten Dedicated IFB Branches were opened during the period under review (three of the Branches were those that were approved during the last fiscal year and were on process while the rest eight branches were those targeted to be opened in the current fiscal year. One additional Branch, Alif at Jimma District Office, was approved through supplementary Budget).

However, as per reports he is getting from customers and other Departments, the IFB service at windows of Dasehn Bank Conventional Branches is not uniform. Besides, it is unavailable in many of Dashen Bank Branches as there is no dedicated booth or personnel to attend customers. Customers are also forced to use the conventional booths at branches during extended hours and weekends which at times eroded the public confidence in the service delivery. Branch Operations and Central Processing Department has undertaken a survey to check the status of the IFB service delivery at Branches in order to make the necessary adjustments. The assessment result taken on IFB window activation report shows only 342 Branches responded the assessment questionnaire. From these Branches, 300 branches agreed that their IFB window activation were not as expected and promised to deliver improvement in the future. The rest, 42, Branches are totally behind far from the expectation and they fear to be kicked out from the market. From the assessment result, there is no a single Branch or District offices labelled themselves in comfortable zone.

Table 4. 3 District office IFB Window Activation Status.

NO	DISTRICT	NUMBER OF BRANCH RESPOND	NUMBER OF BRANCH NOT RESPOND	Respond yes per %	LABELED
1	EAST ADDIS	49	3	76	YELLOW
2	SOUTH ADDIS	42	nil	75	YELLOW
3	NORTH ADDIS	46	1	73	YELLOW
4	WEST ADDIS	26	19	73	YELLOW
5	DIREDEWA	25	3	68	YELLOW
6	ADAMA	31	2	67	YELLOW
7	DESSIE	29	nil	67	YELLOW
8	HAWASSA	27	3	64	YELLOW
9	JIMMA	23	3	61	YELLOW
10	BAHIRDAR	26	17	58	RED
11	WOLAYITA	16	7	57	RED
12	MEKELE	2	36		
	TOTAL	342	94		

Keys:

GREEN = the branch or the district is in a positive way but it need consistency.

YELLOW= we are in danger as a branch or district because service does not need compromise we have to deliver as promised.

RED= totally we are far from where we have to be as a branch and district .it will totally kick out us from the market

According to the Deputy Chief, dedicated IFB branches have registered a remarkable resource mobilization performance compared to their target.

When we look at the performances report of dedicated IFB branches for the month ended March 31, 2021, we can observe an incremental total of 9,986 customers were attracted by full- fledged branches as of March 31,202. The performance of these Branches is 170% of the target, i.e. 5,887 customers. All braches, except one, have achieved their respective account opening target.

Table 4. 4 Full-Fledged IFB Branches - Number of A/C Holders

District Offices	Branches	Actual	Target	%age
Dire Dawa	Ansar	630	212	297%
Dire Dawa	Garad Wilwal	613	212	289%
West Addis	Anwar	1,210	472	256%
West Addis	Taqwa	483	212	228%
Wolaita	Tora	3,232	1,434	225%
Dire Dawa	Bukhari	596	496	120%
Adama	Baraka	854	800	107%
Dessie	Mohammed Al -Amoudi	1,054	1,049	100%
Adama	Sof oumer	157	1,000	16%
Dessie	Kelela	1,077	-	
Jimma	Alif	80	-	
Total		9,986	5,887	170%

All of the three IFB district heads responded as they are trying support branches through availing the necessary resource for their activation of IFB window in all branches even though their mostly preferred IFB dedicated bricks and mortar service delivery channel.

4.5.7. POS Merchants, Amole Merchant and Amole Agent

The Deputy Chief IFB officer has been interviewed in his office explained that they have tried to reach customers with POS merchants, Amole Merchant and Amole Agent in the year 2020/2021. According to the interviewee, 20 POS machines were distributing to merchants at city and outlying branches. On the other hand, branches could only recruit only 3 amole merchants who opened IFB accounts. However, even if they set some amount of Amole agent to recruit, they could not get the data regarding how many of the agents recruits by the Bank are customers of the Bank's IFB window service.

IFB heads on their side responded that their Branches are reported to have submitted all pertinent documents of potential agents to alternate Channel Department but could not finalize the process due to reported technical problems.

4.5.8. IFB Cards and Amole subscribers

As per the interview made with the focal person from IFB unit, around 13,000.00 Sharik branded cards were delivered to customers this year and its Amole subscribers reached around 8,000.00. However, the performance exhibited in the two channels is far behind against the budget.

Table 4. 5 IFB Card Performance - District Wise

S/N	District	Incremental Plan from QII-QIII			Total Target (Nine Month)	Actual	% Age
		QI	QII	QIII			
1	Adama	903	1,204	1,807	3,915	862	22%
2	Bahir Dar	601	802	1,203	2,606	519	20%
3	Dessie	2,056	2,741	4,111	8,908	2,394	27%
4	Dire Dawa	1,944	2,593	3,889	8,426	1,843	22%
5	Hawassa	806	1,075	1,612	3,494	639	18%
6	Jimma	992	1,322	1,983	4,297	828	19%
7	Mekelle	584	779	1,169	2,532	230	9%
8	Wolaita	1,003	1,337	2,006	4,345	1,557	36%
	Sub-Total	8,890	11,853	17,779	38,522	8,872	23%
9	North Addis	589	786	1,179	2,553	928	36%
10	South Addis	698	930	1,395	3,023	1,033	34%
11	West Addis	1,185	1,580	2,371	5,137	2,029	40%
12	East Addis	638	851	1,276	2,765	687	25%
	Sub-Total	3,110	4,147	6,221	13,478	4,677	35%
	Grand Total	12,000	16,000	24,000	52,000	13,549	26%

Table 4. 6 Amole Performance - District Wise

Districts	Year 2020/2021 Target	3rd Quarter Target	3rd Quarter actual 2021	3rd quarter Variance Actual Vs Target 2021	3rd qur. Act. Vs Target (%)	Rank Quarter Performance March 2021
Adama District	16025	4,808	569	(4,239)	12%	6
Bahir Dar District	24160	7,248	505	(6,743)	7%	8
Dessie District	16979	5,094	2,394	(2,700)	47%	1
Dire dawa District	15980	4,794	1,161	(3,633)	24%	3
Hawassa District	17721	5,316	798	(4,518)	15%	5
Jimma District	14888	4,466	302	(4,164)	7%	9
Mekelle District	21228	6,368	143	(6,225)	2%	12
Woliata District	12487	3,746	911	(2,835)	24%	2
Up country Total	139468	41,840	6,783	(35,057)	16%	
East District	32380	9,714	229	(9,485)	2%	11
North District	31117	9,335	201	(9,134)	2%	13
South District	26969	8,091	201	(7,890)	2%	10
West District	27566	8,270	875	(7,395)	11%	7
City Total	118032	35410	1,506	(33,904)	4%	
Total	257,500	77,250	8,289	(68,961)	11%	

Source: ACD (April 2021)

The Deputy Chief in his part added witnessed that his sharik branded IFB card is not interoperable while he tried to use it in another Bank's ATM machines. However, other respondents confirmed as they have not faced any problem while they withdraw money from ATM machines of other Banks' using Sharik Branded Debit Card.

According to the information obtained from the above interviewee, it can be concluded that IFB sharik card has a compatibility issue which could not seamlessly interface with other Banks ATM machines. The other major issue observed in

connection with service charge while IFB ATM card users withdraw money. The charges configured increases whenever withdrawal amount increases due to limitation of ATM machines to differentiate between IFB and Conventional cards. This resembles interest based transaction, which is forbidden clearly by IFB window.

4.5.9. Product Development

Deputy Chief as well as Senior Manager Retail & MSME discussants forwarded the major activities that IFB and other Departments performed in connection with IFB product development including commercialization of IFB guarantee (kafala) and other product related initiatives.

The deputy chief further stress that as a strong criticism forwarded by their SAC members, customers and experts in the industry for the lack of profit-sharing investment accounts at IFB window. Partnership based products like investsmnet deposit accounts and Mudaraba/Musharaka financing products believed to be the main purpose of IFB business. Though, efforts are being exerted to rollout such products at their IFB window services, they were not able to introduce new products since the launch of the IFB window service. Products like Mudarabah Saving and Investment Accounts that were well defined and got approval from the Executive Management and SAC could not be launched due to limitation of the existing core banking system.

Hence it is easy to understand that all of the respondents strongly agreed that Dashen Bank IFB window has challenges in developing innovative Islamic profit and loss sharing products. They mentioned that the inadequacies of the legal and regulatory framework related to IFB, lack of competent institutions that can provide dedicated consultancy services in financial product development and training, and so on as major deterrents. These problems are underpinned by the lack of well-trained professionals in the field of interest-free banking and financing (IFB). With regard to the challenges facing IFB window in availing IF products, Iqbal, Ahmad & Khan (2009) stated that inadequate regulatory and legal framework are one of the challenges for the

development of Islamic banking and other FIs as Islamic banking lacks effective supervisory framework. It caused the prevailing system inefficiency and hence it deserves a serious attention.

With regard to the IFB financing products, the two IFB experts (Deputy Chief and Senior Manager IFB Retail & MSME) unanimously confirmed that not only Dashen Bank, but also most of Islamic banking services in Ethiopia are executed through Murabaha mode of financing. For example, more than 90% of the IFB contracts are executed through the Murabaha means of financing. They further added that Dashen Bank rarely used the other instruments of financing; for instance, if one looks at the current budget year report of DB for the month of March 31, 2021 in terms of total loan disbursement and composition of the portfolio shows ETB 1,212,043,637.39 and 99%, respectively financed using Murabaha instrument. Thus, this suggests almost all Dashen Bank's IFB financing is executed through Murabaha contract. According to the participant IFB experts, Murabaha mode of financing is the most popular means of IFB and financing because of the following reasons, viz.

- It is simple to implement the contract,
- It involves relatively less risk compared to the Profit and Loss Sharing (PLS) modes
- The bank could receive the price of the inputs plus the markup either immediately or in monthly installment from the client
- It is mostly used for short-and-medium-term financing needs.
- Most of the time it is used for domestic trade and service (DTS), which does not require the FIs a foreign currency (because the acquisition of inputs is made from the domestic market)

In terms of the most appealing IFB and financing schemes, all of the IFB experts mentioned that because of its simplicity and less risky nature, Murabaha mode of financing is most suitable for the bank or any financier. The next most appealing Interest-free financing, according to the four of Corporate IFB Relationship Managers is Qard Hassan. *Qard Hassan* is the only Islamic financing instrument which can be given to the client in cash as opposed to in-kind. In this mode of financing the bank

lends the client a certain amount of loan directly in cash without any kind of interest and profit sharing. While extending credit in the form of *Qard Hassan*, the bank (DB) is not even charging the service fee. Because it is extended only to those clients who are engaged in the export activities so that the client who uses a loan in the form of *Qard Hassan* will agree to exchange the foreign currency in the bank.

For the remaining interest-free financial instruments, all of the interviewees agreed that the rest of the financial contracts either require additional regulatory framework for their implementation, or highly risky contracts which require heavy investment in monitoring and supervision, management, and manpower. Hence, they claimed that taking into account the current economic and financial eco-system these contracts are very difficult to enforce.

Therefore, taking the responses of IFB experts into account, it is learned that the *Murabaha* means of financing is the most commonly executed Shari' ah-compliant financing in Dashen Bank S.C. and financing through other schemes is very insignificant. It is also empirically established that *Murabaha* tops the list of the available schemes of Islamic finance in terms of acceptance worldwide (Choudhury, 2001). In the same vein, Hassan, et al. (2013) discovered that though the profit or loss sharing (PLS) schemes of Islamic financing generates a lucrative return, many Islamic Banks in Malaysia prefer the *Murabaha* contract because there exist well-articulated contracts; it does not require credit record of the borrower and usually entails lower administrative costs. *Murabaha* comes quite close to conventional lending and therefore it is easy to adopt by conventional bankers venturing into Islamic finance through a separate window. It is also simple and easy to implement. However, like conventional lending, the *Murabaha* contract obliges the borrower to provide security or collateral (Magbul & Hassan, 2017).

The above paragraphs, therefore, implies that the Bank is more focused on designing and mobilizing *Wadia Savings* account and *Qard* current account (both do not have any financial reward or return for the depositors). Moreover, the bank is deploying its mobilized resource on *Murabaha* financing scheme (cost plus mark up financing). However, according to IFB corporate Relationship Managers interview

results, the researcher learned as there is huge demand for profit and loss sharing deposit and financing facilities.

4.5.10. Marketing Activities and marketing mix

According to the information obtained from the IFB unit Deputy Officer, marketing and Customer Experience Department has carried out various activities to promote the Bank's IFB business. He further said, talking points were prepared and aired on DB's partner radio stations at various points in time and a new TV advertisement was produced and aired on major TV stations during this year.

According to The interview result obtained from Deputy Chief the researcher able to understand that the Bank sometimes send TV scripts for Shari' ah screening before it is aired to the public. However other marketing collateral, radio and other social media promotions are not verified by the SAC.

With regard to the price of IFB products, the senior manager for IFB retail and MSME business segment responded that the unit uses the conventional interest rate as a benchmark to set the prices of IFB financing products. IFB charges a little higher price than the conventional wing to compensate the price risk that can be emerged from inflation. Moreover, he believes the IFB customers are not getting the replica of all conventional products like line of credit facility, revolving facility, overdraft and other well renowned IFB products like Ijara, Salam, Mudarabha and Musharaka due to IT limitations and vesting the responsibility of IFB product development for product development officers who do not have sufficient knowledge about IFB products. A deposit product with financial return is also not launched. The unit is only confined with providing Wada qard, and kafala iFB products.

According to the above informant, at present, almost all of the Islamic financing in Dashen Bank have been accomplished through Murabaha and Qard transactions.

This is not surprising; Murabaha instrument dominates Islamic means of financing not only in the banking sector and all IFB windows in Ethiopia, but also in worldwide (Choudhury, 2001). As it has been witnessed by existing literature, early in the 60s

and 70s Islamic banking and finance was mainly based on PLS. Apart from the relationship between the FI and the depositor, in which a form of PLS that is based on Mudaraba is established, Islamic FIs in the vast majority now avoid PLS as the most important basis for their investment activities. Instead, such activities operate largely on the basis of contracts that are considered mark-up based such as Murabaha, Ijarah, Salam, or Istisna'. For the bulk of their investment operations, FIs that offer interest-free financial products and services have opted for these mark-up based, relatively safe contracts, which are similar, in some respects to lending on the basis of fixed interest.

On the other hand, one of IFB head at West Addis district office raises his concern that though the bank is trying to provide its IFB products via various distribution channels, the services customers getting from these channels are not satisfactory due to IFB window deactivation and customer interface issues.

Therefore, from the data collected to assess the marketing mix of Dashen Bank's IFB marketing mix, it is easy to conclude that Lack of diversified products, weak distribution channel and higher pricing of IFB products and weak Shari' ah screening on promotions shall be give due attention for the necessary action.

4.5.11. Organizational Structure of the Retail & MSME IFB

As the in-depth Deputy Chief of IFB officer interviews showed Dashen Bank launches Interest Free Banking products and services under the Brand name Sharik, which means sharing, having received the approval from the National Bank of Ethiopia on 25 October 2017. The Bank however launched its service on March 5, 2018.

The Bank has opted for the window operating model which leverages on the existing conventional infrastructure where all the processes, operations, sales, channels, finance, branches, compliance, audit, all and all functions are provided through the current Bank's infrastructure. The Unit has been organized by a leader known as Deputy Chief IFB officer who is responsible for the overall IFB window initiatives as a focal point that drives the IFB window strategy and objectives across the Bank.

Under his supervision, there are two IFB business segment lead by Director, Corporate IFB Department and Senior IFB Retail & MSME.

Deputy Chief further added that the Bank is selected dedicated specialist relationship managers and staff engagement model to manage relationship with IFB clients as a mode of interaction in which Relationship managers to serve as single point of contact with optimal coverage ratios.

As clearly pointed out by the above interviewee, there is role confusion between Chief Banking Operation Office and Deputy Chief IFB office since District offices directly report their IFB operation to Chief Banking Operation rather than reporting to IFB office.

Moreover, there are only around 50 Branch Relationships out of 440 branches. This makes it very difficult to get point of contact in every 90% of Branches.

Through the discussion made with all interviewee, they all responded that the organizational structure of the IFB business segment of Dashen Bank was not restructured to respond to challenges observed in running the business segment. Corporate IFB Department was created along with a Retail & MSME IFB work unit. The institution of the Corporate Department is bearing fruits. However, the Retail & MSME sub segment which is currently run by a Senior Manager is having limitations in properly running the segment where much of the resources, especially in Deposits as expected.

4.5.12. Weak legal and supervisor framework

The Deputy Chief IFB Officer claimed that the legal framework is not relaxed to enable partnerships and other financing schemes. This limits financing capacity of the bank and client's preference for financing needs. He further notified that In Ethiopian Banking sector, the conventional as well as Islamic banks are subject to the supervision of a single supervisory authority i.e., Conferring to Article 3 of limitation on investment of bank, directive SBB/12/1996, "A bank may hold shares in a non-banking business only up to 20% of the firm's share capital and total holdings in such business

shall not exceed 10%”. This article creates conflict to use the *Musharaka* arrangement in which a bank could own majority of the share of a business or investment at the time of the authentication of the contract. Thus, this directive obstructs the execution of this product at all.

Chapter Five: Summary of Findings, Conclusions and Recommendations

5.1. Summary of Findings

The major goal of this study is to examine the challenges that Ethiopian Commercial Banks encounter when offering an IFB window by looking at Dashen Bank S.C. IFB unit. An in-depth interview was conducted to gather the perspectives of various Dasehn Bank IFB window personnel. The findings of the research from the information gathered through interview suggest that:

- ✓ Lack of awareness and skepticism were two of the main impediments which inhibit potential IFB customers not to use IFB window service.
- ✓ The presence of Non-interest bearing account at conventional wing has created unnecessary confusion against IFB deposit products which makes very difficult to assure whether the Bank followed one of the most important principle of IFB “segregation of IFB fund”
- ✓ The existing core banking system of Dashen Bank s.c. lacks some basic features to run an IFB business and rollout renown plain vanilla IFB products.
- ✓ Activation of all IFB window of Dashen Bank S.C. is below the standard and the number of IFB Dedicated Branch opened by the Bank is very small.
- ✓ The performance of Amole merchant, POS merchant, Amole agent, IFB debit Cards and Amole subscribers are much far from the corresponding budgets.
- ✓ Dashen Bank s.c. is more focused and concentrated on deposit products that do not have financial return. Moreover, the bank is deploying most its IFB resources on Murabaha financing scheme.
- ✓ The IFB Retail & MSME sub segment of Dasehn Bank which is currently run by a Senior Manager is having limitations in running the segment.
- ✓ Weak legal and regulatory issues are also observed in IFB dispute resolution and in some articles of proclamation.

5.2. Recommendations

The main objective of the study was to provide insight on the major challenges faced by IFB window business. For this reason, qualitative research was conducted on Dashen Bank S.C. through in depth interview analysis. Findings were laso drawn and summarized. Based on the key findings and conclusions drawn, the researcher forwarded the following suggestions to IFB unit of Dashen Bank S.C, Dashen Bank itself and National Bank of Ethiopia.

5.3. Recommendations for IFB window of Dashen Bank S.C.

Without prejudice to the measures and actions to be taken by the National Bank of Ethiopia and Dashen Bank, the IFB window shall give due attention for the following suggestion to revamp its overall operation.

- ✓ Lack of ownership was identified as one of the constraints that hinder the performance of IFB operation. Hence, working with all concerned Departments and work units to fine-tune the IFB window service delivery at Corporate Service Centre, Districts and Branches should be given due attention;
- ✓ Low activation of IFB window across the Bank was one of the observations found from the study. Therefore, IFB unit shall engage with all concerned Departments, Districts and Branches in easing the activation challenges identified in the IFB window service and rectify the irregularities reported;
- ✓ IFB product concentration problem was also found in the study as another hindrance for IFB window service. It is therefore better for IFB window of

Dashen Bank, in collaboration with product development unit, to refine and develop new true IFB mode of products and services (especially Mudaraba Saving and fixed time Deposits) that meet the needs of the IFB window customers.

5.4. Recommendations for Dashen Bank S.C

- ✓ One of the major impediments facing the operation of IFB window in particular was role conflict between chief banking operation office and IFB unit have on District offices and Branches. Their direct reporting line of IFB business operation is for Chief Banking operation office rather than Deputy Chief IFB offices. To alleviate the confusion, Dashen Bank should embed District office and Branch Managers who have dual reporting lines – one to Deputy Chief IFB office and the other to Chief Banking Operation Office. The IFB window needs to get the same respect as other businesses within the bank. This is because the critical success factors of IFB window are the empowerment of the Deputy Chief IFB office to have a strong voice in the executive committee, the acceptance of the business model by the other business heads and the dual matrix reporting structure for District office and Branch Managers who are embedded in various areas of banking.
- ✓ Lack of awareness was identified as one of the impediments which inhibits IFB client Muslim not to use IFB products and benefit from both service; hence, all the concerned of Dashen Bank should promote IFB products through designing and implementing proper communication channels and marketing strategy which is appropriate for those target groups.
- ✓ Though the bank established internal Shari' ah review and internal Shari' ah compliance unit, the setup is not in a way to ensure a stable functioning system in accordance with the requirements of IFB principles. Therefore, the internal Shari' ah review unit shall be under the umbrella of internal audit and its internal compliance to work under the overall guidance and supervision of the SAC of the bank.

- ✓ From the standpoint of information systems and as shown in the study, Dashen bank's IFB window is confronted with challenges that are impeding its expansion and limiting the banks' activities. These problems are solvable, and technological advancements are bringing more and more solutions to present problems. Therefore, the bank shall assess its existing core banking solution gaps and try to procuring a new system or enhance the existing system by making necessary adjustment. Moreover, the Bank shall give due attention for both "Click and mouse technology" to improve the efficiency of IFB window. As indicated in finding section, though efforts have one to reach customers other than bricks and mortar channels, the efforts were not successful as expected. Therefore, the bank expected to equate the customer experience
- ✓ All the concerned stakeholders of the Bank should promote their products through designing and implementing proper communication channels and marketing strategy which is appropriate for those target groups.
- ✓ The Bank must attempt to address the problem of commercializing profit and loss sharing based IFB products as much as possible.

5.5. Recommendations for the National Bank of Ethiopia (NBE)

- ✓ As has been indicated in the discussion session, one of the impediments of IBF in Ethiopia is lack of IBF experts even at the National Bank level. The IFB is currently regulated by the same regulators who are regulating the conventional banking wing. However, most of the personnel at the NBE are trained in conventional banking and hence, lack the expertise skills in IF Banking and Financing. Therefore, to ensure the efficient operation of the IF business as an essential part of the financial system of the country, and as its regulatory responsibility, it is suggested that the NBE needs to equip itself with trained and experienced personnel in the field of IF banking.

- ✓ Lack of public awareness about IF Banking and Financing was one of the formidable challenges facing the IF business in Ethiopia. It was reported by the IF experts of Dashen Bank that in the commercial banks which have IF window still large number of IFB customers are holding suspicion over the real difference between the two. Thus, it is recommended that the Bankers Association, the Shari' ah Supervisory Board, and NBE in collaboration with higher learning institutions should frequently organize awareness creation symposiums and arrange for more and up-to-date training programs for IF staffs.

- ✓ According to this study, nonexistence of National/Central Shari' ah board, one Shari' ah governance component, is another issue that hinders the performance of IFB window. Therefore, it is better to establish the central Shari' ah board at NBE to guide product development for the entire IF banking sector, resolve Shari' ah interpretation related issues between Banks's and in some cases to guide the courts regarding IF finance related cases. The establishment of central Shari' ah board will help in harmonizing Shari' ah related matters among IF banks in the country. If possible, the board might have been used as a dispute resolution tools by authorizing the board and empowering a legitimate power to have the final in case of any dispute regarding Shari' ah interpretation.

- ✓ It is indicated that there is no sufficient and enabling legal and regulatory framework for the business of Islamic or interest-free banking. If this will persist, it will have adverse repercussion on the overall operation and acceptability of the IFB window. As a result, the National Bank of Ethiopia is advised to reconsider and revise the legal and regulatory framework for inclusion of IFB in the financial directives and promote the sector. This would help legitimately navigate any future issues that may arise as the business grows.

- ✓ It was disclosed that the IBF sector in Ethiopia is suffering from trained and qualified professionals in the field of Islamic Banking and Financing (IBF) at all levels vis., at NBE level, the Shari' ah Advisory Board, at the individual bank levels. Moreover, there is a shortage of manpower for IFB window services at

department and branch levels. This is due to the fact that, most of the personnel who are currently working in IBF window were trained for conventional banking. Therefore, it is suggested that the NBE in collaboration with the *Shari' ah* Advisory Board to organize trainings required for the development of professionals at every level on *Shari' ah*-acquiescent banking and financing businesses.

- ✓ There is no doubt that the advent of IFB business has introduced a fresh challenge as how IF disputes are to be resolved.

If a dispute arises, interest free products are judged according to laws and regulations that may be in conflict with *Shari' ah*. If this is allowed to continue, the IF financial edifice will be weakened. Several critics have noted that IF finance cannot be fully implemented without the establishment of a specialized organization that judges it. The present procedure for hearing and determining IF banking and finance disputes by civil or common law courts will be counterproductive to the practice of IF banking and Finance. (Hussain, 2011)

As a result, it is critical for the maturation of the Islamic banking industry to build a dispute resolution mechanism in which Islamic finance transactions are judged according to *Shari' ah*. The best solution for the issue according to the researcher is NBE and the concerned organs shall find to broadened the scope *Shari' ah* court (where a law only to personal and family matters are heard authorized since 1942) to deal with IF finance disputes as well. the establishment of arbitration and mediation dispute resolution systems shall also have promoted by NBE.

- ✓ Finally, the National Bank of Ethiopia is advised to relax Article 3, and related articles of the legal framework which discusses about limitation of bank's investment in other non-banking business so that the profit and loss sharing and other modes of financing contracts to be fully operationalized.

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Appendix 1 IFB deposit position of Commercial Banks in Ethiopia of March2021

SN	Name of Bank	Wadia Saving		Wadia (Qard) Current		Mudarabah Saving		Mudarabah term		Total	
		No.	Value	No.	Value	No.	Value	No.	Value	No.	Value
1	Abay Bank	89,254	973,239,540	1,479	142,655,605	-	-	-	-	90,733	1,115,895,144
2	Awash Bank	548,180	4,616,498,094	4,881	1,085,340,249	-	-	-	-	553,061	5,701,838,343
3	Bank of Abyssinia	519,680	6,388,137,591	-	-	-	-	-	-	519,680	6,388,137,591
4	Buna Bank	47,995	535,000,000	-	-	-	-	-	-	47,995	535,000,000
5	CBE	3,631,476	42,506,971,193	12,411	3,267,442,720	3,486	203,878,732	2	17,000,000	3,647,375	45,995,292,645
6	COOP	1,742,381	8,134,430,153	6,625	1,386,716,852	441	38,950,942	5	26,500,000	1,749,452	9,586,597,947
7	Dashen Bank	237,048	3,017,264,075	4,105	974,178,384	239	1,118,616	-	-	241,392	3,992,561,075
8	Hibret Bank	107,166	1,385,045,752	2,879	301,267,256	-	-	-	-	110,045	1,686,313,008
9	NIB	193,972	2,299,616,232	2,140	361,598,716	494	22,784,750	-	-	196,606	2,683,999,698
10	OIB	460,000	3,448,186,000	1,000	1,028,500,000	1	10,800,000	-	-	461,001	4,487,486,000
11	Wegagen Bank	186,424	1,186,987,861	1,491	144,133,016	838	820,360	1	33,784,452	188,754	1,365,725,689
	Total	7,763,576	74,491,376,491	37,011	8,691,832,799	5,499	278,353,400	8	77,284,452	7,806,094	83,538,847,141

SN	Name of Bank	Total value of Deposit	Outstanding financing	Deposit to Financing
1	Abay Bank	1,115,895,144	438,408,571.43	39%
2	Awash Bank	5,701,838,343	1,634,415,408.94	29%
3	Bank of Abyssinia	6,388,137,591	486,305,010.28	8%
4	Buna Bank	535,000,000	-	0%
5	CBE	45,995,292,645	5,656,475,643.47	12%
6	COOP	9,586,597,947	5,827,361,624.04	61%
7	Dashen Bank	3,992,561,075	1,212,043,637.39	30%
8	Hibret Bank	1,686,313,008	764,906,397.23	45%
9	NIB	2,683,999,698	690,706,749.29	26%
10	OIB	4,487,486,000	3,641,716,690.00	81%
11	Wegagen Bank	1,365,725,689	380,287,084.61	28%
	Total	83,538,847,141	20,732,626,817	25%

Appendix 2

Semi-structured interview guide to Dashen Bank S.C. Interest Free Banking Managerial Staffs

In-depth individual interview (semi-structured interview guide)

Focus: Internal and External Challenges of IFB Business in Ethiopia

Research title: Challenges of Interest Free Banking in Ethiopia: In case of Dashen Bank S.C.

Objectives of the study: The aim of the study is to draw conclusion and to provide insight on the major challenges faced by Interest Free Banking business.

Interview Type: Semi structured in depth interview

Respondents: IFB Chief, Director, senior managers and IFB District Heads

Number of respondents: Ten

How to conduct: through Face to Face and telephone

How to recruit respondents: Names and Mobile phone contact information gathered from Dashen Bank Human Resource Department. (at least fifteen contact information will be required)

How to record the interview: By filling in a prepared form and written notes

Who will conduct the Interview: By the researcher

Semi-structure interview questions

1. What are the major Internal (institutional) constraints of your Interest free banking unit?
2. What are the major external (country level) constraints of Interest free banking?
3. What is your opinion with regard to taking your Bank's senior management and all employees in taking ownership to deliver the IFB business successfully?
4. What type of IFB Dispute resolution techniques are applied in your bank in case of any IFB related dispute arises in your Bank?
5. What type or Model of Shari' ah Governance framework applied in your bank? How many Shari' ah advisory committee that your bank assigned for?
6. How do you see the functionality of your Bank's core banking system in connection with real time profit distribution and administrating Mudaraba Fixed time deposit profit management?
7. How your IFB window segregate IFB funds against conventional fund.
8. How Shari' ah requirements are followed in their true spirit while structuring and developing IFB products in your Bank?
9. On which of the IFB products and services your bank has encountered in introducing and operationalizing because of the banking eco-system and financial/banking/ laws?
10. What are the possible risks that your bank may bear by applying IFB products and services in Ethiopia's market? Why?
11. What are the gaps observed in IFB service delivery channels or customer interface application compared with your Bank's conventional delivery channel serviceability?
12. Do you have any other suggestions to be provided by this study?

Thank you Very Much!