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Financial Performance of banking in Ethiopia: A Comparative Study of Interest-Free Banking and Conventional Banking

A Research Paper Submitted in Partial Fulfillment of the Requirements for the Degree of Masters of science in Accounting and Finance

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Addis Ababa, Ethiopia

Declaration

I hereby declare that the thesis titled "*A Comparative Study of Financial Performance between Interest-Free and Conventional Banking in Ethiopia*" is my original work, conducted under the guidance and supervision of Dr. Kelifa Srmolo.

I confirm that this thesis has not been previously submitted, in whole or in part, for any academic degree at any university or institution.

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Statement of certification

This is to certify that the thesis titled "*A Comparative Study of Financial Performance between Interest-Free Banking and Conventional Banking in Ethiopia*" has been submitted to by Zemzem Ahmed in partial fulfillment of the requirements for the Degree of Master of science in Accounting and Finance complies with the regulations of the university and meets the accepted standards with respect to originality and quality.

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Abstract

The main objective of the research was to analyze and compare the financial performance of conventional and interest-free banking systems in Ethiopia, focusing on key financial ratios. The study adopts a quantitative research methodology, using secondary data from the financial statements of selected banks over a period of three years (2021-2023). Key financial ratios such as profitability, liquidity, risk and solvency, leverage, and efficiency ratios are analyzed to evaluate the financial health and performance of the two banking systems. The findings of the study reveal that the majority of the differences in financial ratios between the two banking models were not statistically significant. However, Interest-free banks while more stable, faced higher operational costs relative to their income. The comparative analysis highlights relative strengths and weaknesses of each banking system, with conventional banks demonstrating greater resilience to economic shocks and interest-free banks showing higher efficiency in using assets and equity to generate profits. The study recommends that conventional banks focus on technological innovation and enhanced risk management practices to maintain competitiveness. Interest-free banks are suggested to optimize their debt management and improve cost efficiencies to ensure long-term sustainability. Additionally, the study suggests further research into the impact of regulatory frameworks on the performance of both banking systems and their role in promoting financial inclusion. This research contributes to the understanding of financial performance in Ethiopian banking and provides valuable insights for both policymakers and banking institutions looking to enhance the effectiveness and stability of their operations

Key Words Interest-Free Banking, Conventional Banking, Financial Performance, Comparative Analysis, Financial Ratios

Table of Contents

List of Tables

List of Figures

List of Acronyms/Abbreviations

AUR	Asset Utilization Ratio
CAR	Capital Adequacy Ratio
CPIDR	Cash and Marketable Securities to Deposits Ratio
CR	Capital Ratio
DER	Debt to Equity Ratio
DTAR	Debt to Total Assets Ratio
EM	Equity Multiplier
IER	Income to Operating Expenses Ratio
IFBs	Interest-Free Banks
LAR	Loan to Asset Ratio
LDR	Loan to Deposit Ratio
OER	Operating Efficiency Ratio
PER	Profitability to Expense Ratio
ROA	Return on Assets
ROD	Return on Deposits
ROE	Return on Equity
TDTER	Total Deposits to Total Equity Ratio

CHAPTER ONE
INTRODUCTION

This chapter introduces the concept of interest-free banking and its comparison with conventional banking, focusing on their financial performance in the context of Ethiopia. It outlines the background of the study, statement of the problem, the objectives, and the significance of the research. Furthermore, it discusses the scope, limitations, and organization of the study, setting the foundation for a detailed examination of the subject.

1.1. Background of the Study

Banking plays a pivotal role in modern economies, providing essential services for financial intermediation, investment, and risk management. In Ethiopia, the banking sector is characterized by two primary models: Interest free banking and conventional banking. These systems, while serving the same fundamental purpose, differ significantly in terms of their operational frameworks, principles, and financial practices.

The financial sector, encompassing banks, insurance companies, stock markets, and other financial institutions, serves as the backbone of economic growth and development by facilitating the flow of capital, enabling investments, and managing financial risks. A robust financial system is essential for fostering sustainable economic development, as it influences key economic indicators such as GDP growth, inflation, employment rates, and overall economic stability (Khan & Bhatti, 2008). In this context, banks, whether Interest free or conventional, play an instrumental role in shaping the trajectory of national economies.

The primary distinction between Interest free banking and conventional banking lies in their adherence to distinct regulatory frameworks. Interest free banking operates in accordance with the principles of Sharia law, which prohibits the charging of interest (riba) and restricts investments in industries considered unethical or harmful, such as alcohol, gambling, and pork production. In contrast, conventional banking generally follows an interest-based model, where financial transactions are structured around interest-bearing loans and deposits. These structural differences result in varied risk-sharing, financing, and profitability mechanisms within each system (Aziz, Husin & Hashmi, 2016).

In contrast, conventional banks benefit from an interest-based model that provides a consistent source of revenue through interest-bearing loans and deposits. This model allows conventional banks to scale their operations and manage liquidity risks with relative ease. However, conventional banking is not without its criticisms, particularly regarding its reliance on interest, which can exacerbate income inequality and lead to financial exclusion for segments of the population that adhere to ethical or religious prohibitions on interest-based transactions (Khan & Bhatti, 2008).

The growth of Interest free banking in Ethiopia is indicative of a broader global trend toward interest-free financial systems, driven by a growing demand for ethical and socially responsible banking solutions. Islamic finance in Ethiopia is offered through both interest-free banking windows in conventional banks and fully-fledged Sharia-compliant financial systems, such as ZamZam Bank, the first fully operational Islamic bank in the country. The Ethiopian market offers significant opportunities for Islamic finance, including high public demand, untapped capital, and a large customer base. Despite these opportunities, Islamic finance faces challenges, including regulatory constraints, negative perceptions, and a shortage of skilled professionals. Additionally, the absence of a cohesive legal framework for Islamic finance in Ethiopia represents a significant barrier to the sector's expansion (Suadiq & Nissar, 2021).

Despite these challenges, the potential for growth in Interest free banking in Ethiopia remains substantial, research on ZamZam Bank highlights both the challenges and opportunities present in the Ethiopian market. The bank faces issues such as regulatory gaps, lack of expertise, and customer understanding, but it also stands to benefit from untapped market potential, growing public interest, and potential economic benefits that extend beyond the Muslim community. This indicates that the advantages of interest-free banking can outweigh its disadvantages, both for individual institutions like ZamZam Bank and for the country as a whole (Abdulsemed, 2022).

The increasing interest in interest-free banking in Ethiopia, driven by the country’s economic growth and the needs of its Muslim population, suggests a promising future for the Islamic finance sector. Despite challenges such as customer awareness, regulatory hurdles, and resource limitations, the continued demand for ethical financial services creates a strong foundation for

growth in this sector. Moreover, global trends point to an increasing acceptance of Islamic finance, further bolstering the potential for Interest free banking in Ethiopia (Tsion, 2017).

This study aims to compare the financial performance of both Interest free and conventional banks in Ethiopia. Examining key financial indicators such as profitability, growth and risk management, provide valuable insights into which banking model offers a more sustainable and equitable framework for the Ethiopian economy. In doing so, the study contributes to the ongoing debate on the effectiveness of Interest free banking in the Ethiopian context, with implications for both financial institutions and policymakers.

1.2. Statement of the problem

The financial sector plays a pivotal role in the economic development of any country, including Ethiopia (Adera & Abdisa, 2023). This role is increasingly shaped by two primary banking systems: Interest free banking and conventional banking. While both systems serve similar economic functions, they differ fundamentally in their operational frameworks and underlying principles. Interest free banking, governed by Sharia law, prohibits the charging of interest (riba) and restricts investments in industries deemed unethical, such as alcohol, gambling, and pork (Asari, 2024). In contrast, conventional banking operates on an interest-based model and does not adhere to these religious and ethical constraints (Aziz, Husin, & Hashmi, 2016). These foundational differences raise important questions about the financial performance of these banking models, particularly in emerging economies like Ethiopia, where both systems coexist and are experiencing growth.

Despite the growing presence of interest-free banking in Ethiopia, limited empirical research compares the financial performance of interest-free and conventional banks within the country's unique economic and regulatory context. Most existing studies focus on international settings (Salman & Nawaz, 2018), leaving a gap in understanding how these two banking systems perform comparatively in Ethiopia. Specifically, there is a lack of research assessing key performance indicators such as profitability, liquidity, risk and solvency, leverage and efficiency ratios within the Ethiopian banking sector. This gap hinders a comprehensive understanding of the financial dynamics between the two banking models in the context of Ethiopia's distinct economic conditions. This research gap is notable given Ethiopia's market conditions, regulatory frameworks, and socio-economic dynamics, which may influence the performance of each banking model differently. To bridge this gap, it is essential to assess the financial performance of both banking models.

This study looks at how well interest-free and traditional banks in Ethiopia are doing financially by comparing various financial ratios. These ratios include indicators of how profitable, liquid, risky, solvent, leveraged, and efficient the banks are. The study by Blessing, H., & Sakouvogui, G. (2023) uses these ratios to analyze the financial performance of the banks.

The study evaluated the relative strengths and limitations of these banking models, focusing on measurable financial performance indicators stated above. This approach could provide actionable insights for banking institutions, enabling them to optimize resource allocation, enhance operational efficiency, and improve financial outcomes. Focusing on controllable factors, the study offered practical recommendations for stakeholders of the financial sector.

1.3. Basic Research Questions

- ✓ What is the difference in profitability between Conventional banks and Interest-Free banks in Ethiopia?
- ✓ How does the liquidity position of Conventional banks compare to that of Interest-Free banks in Ethiopia, based on liquidity ratios?
- ✓ What is the Risk and solvency of Conventional banks versus Interest-Free banks in Ethiopia?
- ✓ How does the Leverage & Efficiencies of Conventional banks compare to that of Interest-Free banks in Ethiopia?

1.4. Objectives of the Study

1.4.1. General Objectives

The general objective of this study is to evaluate the financial performance of Islamic Banks in Ethiopia in comparison to conventional banks

1.4.2. Specific Objectives

- ✓ To compare the profitability between Conventional banks and Interest-Free banks in Ethiopia.
- ✓ To compare the liquidity position of Conventional banks and Interest-Free banks in Ethiopia based on liquidity ratios.
- ✓ To assess the Risk and solvency of Conventional banks versus Interest-Free banks in Ethiopia.
- ✓ To compare the Leverage & Efficiencies of Conventional banks and Interest-Free banks in Ethiopia

1.5. Significance of the Study

This study has significant for various stakeholders in Ethiopia's financial sector. It provides valuable insights into the comparative financial performance of IFB and conventional banks.

For financial institutions, the research offers an understanding of the strengths and weaknesses of both banking systems, helping them improve their strategies, operational efficiency and customer service. Academically, the study enriches the literature on Interest free banking in Ethiopia and serves as a foundation for future research in comparative banking performance. For investors and business professionals, the study provides insights that can aid in investment decisions and strategic development within Ethiopia's growing financial market.

1.6. Scope of the Study

This study focused on selected commercial banks in Ethiopia, specifically three full-fledged Interest free banks: Zamzam Bank, Shebelle Bank, and Hijira Bank as well as five conventional banks such as Ahadu Bank, Siinqee Bank, Tseday Bank, Tsehay Bank, and Amhara Bank. These banks have been selected because their establishment dates are relatively close, ensuring comparability between the two banking models.

The study analyzed threeyears of balanced data from 2021 to 2023 for these eight banks, focusing on key financial indicators such as profitability, liquidity, capital adequacy, and asset quality.

1.7. Limitation of the Study

This study has limitations that should be carefully considered when interpreting its findings. First, the study's sample size is limited to eight banks, including both conventional and interest-free banks. This relatively small sample size may not fully capture the diversity of the banking sector in Ethiopia, limiting the generalizability of the findings. Second, the selected banks for the study have differing operational lifespans, as they were established in various months. This variation in age could potentially obscure the results to some extent. Third, the study focuses on banks that were established within a relatively short period, so long-term financial trends might not be fully represented.

Additionally, the study considers data from the period 2021 to 2023, which may not account for long-term trends or the effects of significant external events, such as economic crises or regulatory changes that could impact the financial performance of the banks. While the static ratios provide valuable insights, incorporating growth trajectories in profitability over the three years would offer a more dynamic understanding of the banks' performance, reducing the impact of fiscal year mismatches.

Despite these limitations, the study offers valuable insights into the comparative financial performance of interest-free and conventional banks in Ethiopia.

1.8. Organization of the Paper

The study is organized into five chapters. Chapter 1 introduces the study, including the background, problem statement, objectives, research questions, significance, scope, and limitations. Chapter 2 reviews relevant literature on Interest free and conventional banking, focusing on financial performance and the regulatory frameworks. Chapter 3 outlines the research methodology, detailing the research design, data collection, and analysis techniques. Chapter 4 presents the data analysis and results, comparing the financial performance of Interest free and conventional banks in Ethiopia. Finally, Chapter 5 concludes the study, offering key findings, recommendations, and suggestions for further research.

CHAPTER TWO
REVIEW OF RELATED LITERATURES

2.1. Introduction

This chapter reviews the key ideas and studies related to comparing Interest free and conventional banks. It looks at the tools and methods used to measure bank performance and summarize findings from earlier research on this topic. The chapter also identifies gaps in the existing studies and explains why this research is important. It also sets the foundation for the study and shows how it fits into the broader field of knowledge.

2.2. Theoretical Literature

2.2.1. Introduction to Financial Performance in Banking

Financial performance in banking refers to the ability of a financial institution to generate profit, maintain liquidity, and ensure solvency while effectively managing its assets and liabilities. It is typically assessed through key financial indicators such as profitability, liquidity ratios, capital adequacy, and asset quality, which reflect the overall health and sustainability of a bank. The financial performance of a bank is crucial not only for its survival but also for its ability to contribute to the broader economy through lending, investment, and economic development (Maulana, et.al, 2024).

Comparing the financial performance of different banking models is essential to understanding the strengths and weaknesses of each system, as well as their adaptability to market conditions. This comparison helps to assess how distinct operational frameworks, such as profit-sharing and interest-based practices, impact financial outcomes in varying economic environments. In particular, comparing conventional and interest-free banking models offers insights into how different banking practices affect financial results. Conventional banking, based on interest-bearing transactions, and Interest free banking, which follows Sharia law and prohibits interest, represent two distinct approaches to banking. Understanding the financial performance of these two systems is critical, especially in countries like Ethiopia, where both banking models coexist and serve diverse customer bases (Bashir & Gorton, 2023).

2.2.2. Theoretical Frameworks for Evaluating Bank Performance

Several theories provide the basis for evaluating the financial performance of banks, with particular emphasis on profitability, liquidity, and solvency. These theoretical frameworks are essential for understanding how banks measure and manage their financial health. By examining the relationship between various financial indicators and overall performance, these theories help assess the stability and sustainability of banking institutions (Naser, 2019).

Profitability is one of the most crucial aspects of bank performance. Theories on profitability often focus on key performance indicators such as Return on Assets (ROA) and Return on Equity (ROE). ROA measures a bank's ability to generate profit relative to its total assets, while ROE assesses the return generated on shareholders' equity. Both metrics are used to evaluate how effectively a bank uses its resources to generate earnings, which is critical for ensuring long-term financial viability (RaniBoda, Iftikhar, Bagh & Nadir Shabbir, 2024).

Liquidity management is another important aspect of bank performance. Theories surrounding liquidity focus on a bank's ability to meet its short-term obligations without compromising its operational capacity. Liquidity ratios, such as the current ratio and quick ratio, are commonly used to assess how well a bank can cover its liabilities using its most liquid assets. Proper liquidity management ensures that a bank can operate efficiently, even during periods of financial strain, and is vital for maintaining customer trust and regulatory compliance (RaniBodaet.al, 2024).

Capital adequacy plays a pivotal role in ensuring the financial stability of a bank. The Capital Adequacy Ratio (CAR) is a key measure of a bank's financial strength, indicating the proportion of a bank's capital to its risk-weighted assets. The higher the CAR, the better positioned the bank is to absorb potential losses and withstand economic shocks. Capital adequacy theories highlight the importance of maintaining sufficient capital reserves to safeguard against insolvency and ensure long-term financial stability (Maulana, et.al, 2024).

2.2.3. Risk and Return Theory

The risk and return theory is fundamental in evaluating bank performance, as it explores how banks assess the trade-off between risk and reward in different banking models. Banks must carefully evaluate the potential returns on investment opportunities against the risks involved. This is particularly important when comparing interest-free banking models, such as Interest free banking, with conventional banking models, where risk management approaches can differ significantly. Understanding how each banking model manages risk and the expected returns is crucial for assessing their overall financial performance (Rashaduzzaman, 2024).

In Interest free finance, risk-sharing principles are central to the operational model. Instead of relying on interest-based transactions, Interest free banks utilize profit-and-loss sharing arrangements, where both the bank and the customer share in the financial outcomes of the investment. This model encourages equitable risk distribution and aligns the interests of both parties. In contrast, conventional banks are more focused on risk-taking, particularly through lending and investing with predetermined interest rates, where the risk is borne by the borrower. The difference in these risk management strategies highlights the varying approaches to financial stability and performance between the two banking models (Akash, Reza & Alam, 2024)

2.2.4. Financial Intermediation Theory

The financial intermediation theory explores the critical role of banks as intermediaries between depositors and borrowers. Both conventional and Interest free banks serve this function, but the methods and financial instruments they use to facilitate transactions can differ. Conventional banks act as intermediaries by accepting deposits and providing loans with interest-based returns to both depositors and borrowers. This traditional model focuses on maximizing profit through interest rate spreads, creating a direct link between deposits and loans (Nouman, Hashim, Trifan, Spinu, Siddiqi & Khan, 2022).

Interest free banks, on the other hand, operate without charging interest. Instead, they offer a variety of Sharia-compliant financial instruments, such as Mudarabah (profit-sharing) and Musharakah (joint venture), to serve as intermediaries. These instruments facilitate the transfer of funds while ensuring compliance with Islamic law. The use of these ethical financial instruments highlights the differences in how each banking model practices intermediation.While conventional banks rely on interest-based lending, Interest free banks focus on equity-based

financing and risk-sharing arrangements, which can impact their financial performance and overall stability (Nouman, et.al, 2022).

2.2.5. Interest free Banking: Principles and Performance Indicators

Sharia Law and Ethical Banking

Interest free banking is governed by Sharia law, which establishes the fundamental principles that distinguish it from conventional banking systems. The most well-known principle is the prohibition of riba (interest), which forms the basis of the entire banking structure in Interest free finance. Instead of earning profits through interest, Interest free banks engage in risk-sharing arrangements and ethical investments. Transactions must comply with Sharia, meaning they cannot involve industries or activities deemed harmful or unethical, such as gambling, alcohol, and pork. This ethical framework ensures that Interest free banks foster responsible financial practices while providing services that align with Islamic values (Anjum, 2022).

The core principles of Sharia-compliant activities have a direct impact on bank performance. By emphasizing fairness, risk-sharing, and ethical investments, Interest free banks promote a more equitable distribution of financial returns between the bank and its clients. This model can potentially lead to a more stable banking system, as it is less reliant on the speculative risks and volatility that often characterize interest-based lending in conventional banking. The prohibition of riba also encourages innovation in financial products and services, driving growth in the Interest free banking sector. However, the Sharia-compliant model may also pose challenges, particularly in the areas of liquidity management and access to capital, which can affect the overall performance of Interest free banks (Bertillo & Bertillo, 2022).

Key Performance Indicators for Interest free Banks

To assess the financial performance of Interest free banks, several key performance indicators (KPIs) are used, which are distinct from those employed by conventional banks. One of the primary metrics is profit-sharing (Mudarabah), where banks engage in partnerships with customers, sharing profits and losses from investments. Another key performance metric is Musharakah, a joint venture model where both the bank and the customer contribute capital and share in the profits or losses from a business venture. These models reflect the principles of risk-

sharing and ethical investments in Interest free banking, providing a foundation for performance evaluation (Al-Zaqeba & Basheti, 2024)

In addition to these profit-sharing models, Interest free banks also focus on asset quality and risk management, which are crucial performance indicators. Given the nature of Interest free finance, where banks do not charge interest but rather share in profits and risks, managing asset quality becomes paramount. Non-performing loans (NPLs) and loan loss provisions are critical indicators for assessing the health of Interest free banks' portfolios. Furthermore, Interest free banks face unique challenges in risk management, as they must ensure that all investments are Sharia-compliant while balancing financial returns. This requires rigorous monitoring and evaluation of assets and liabilities to ensure stability and long-term sustainability (Amen & Ndanguza, 2023).

2.2.6. Conventional Banking: Principles and Performance Indicators

Interest-based Banking Model

Conventional banks operate primarily on an interest-based banking model, where they generate profits through the charging of interest on loans and offering interest-bearing deposit accounts. This interest-based model is central to their operations, with banks earning a margin between the interest charged to borrowers and the interest paid to depositors. The model is built on the premise that the risk involved in lending can be compensated by the interest charged, ensuring profitability for the bank. Conventional banks offer a wide range of financial products and services, from personal loans and mortgages to business financing, all of which typically involve interest payments(Nouman, et.al, 2022).

One of the advantages of the conventional banking system is its flexibility in adapting to market changes. As interest rates fluctuate, conventional banks can adjust their lending and deposit rates accordingly, allowing them to maintain profitability. This ability to modify interest rates based on economic conditions, such as inflation or central bank policy, provides conventional banks with a level of responsiveness that helps them remain competitive and stable in dynamic financial environments. However, the reliance on interest-based transactions can expose conventional banks to risks associated with economic downturns or shifts in interest rate policies (Al-Harbi, 2019).

Key Performance Indicators for Conventional Banks

In conventional banking, the financial performance is typically evaluated using several key performance indicators (KPIs) that focus on profitability, liquidity, and solvency. Profitability is often measured through Return on Assets (ROA) and Return on Equity (ROE), which assess the bank's ability to generate profits relative to its total assets and equity, respectively. Net profit margins are also used to evaluate how efficiently the bank manages its income relative to its expenses. These profitability metrics provide insights into the overall financial health and operational efficiency of conventional banks (Choiriyah, Fatimah, Agustina & Ulfa, 2020).

Liquidity management is another critical KPI for conventional banks, as it measures the bank's ability to meet short-term obligations and avoid liquidity crises. Ratios such as the current ratio and quick ratio are used to assess this aspect of performance. Additionally, conventional banks are required to maintain sufficient capital to ensure financial stability, and this is often measured by the Capital Adequacy Ratio (CAR). CAR ensures that banks have enough capital to cover potential losses and continue operating during periods of financial stress. Finally, asset quality, including metrics like non-performing loans (NPLs), is crucial for evaluating the bank's risk exposure and its ability to manage and recover from credit defaults (Nouman, et.al, 2022).

2.2.7. Comparative Studies on Financial Performance of IFB vs. Conventional Banks Global Perspectives

Numerous studies have compared the financial performance of Interest free banks and conventional banks across various regions, including the Middle East, Asia, and Africa. These comparative studies often focus on key performance indicators (KPIs) such as profitability, liquidity, and solvency, as well as risk management strategies. Research has shown that Interest free banks, due to their reliance on profit-sharing and risk-sharing principles, tend to display different financial outcomes compared to their conventional counterparts, especially in terms of stability and risk exposure. For example, studies in the Middle East have suggested that Interest free banks might be more resilient during financial crises due to their ethical financing practices, which prohibit high-risk investments such as speculative derivatives and interest-based lending (Choiriyah, et.al, 2020).

In general, Interest free banks are perceived to be less vulnerable to financial crises because their operations avoid interest-based loans, which can lead to high levels of debt and financial instability. Moreover, the emphasis on risk-sharing in Interest free finance, where both the bank and its customers share in the risks and rewards of investments, offers a more balanced approach to financial management. This has led to observations that Interest free banks have performed relatively better during periods of economic downturn compared to conventional banks, which often struggle due to high exposure to interest rate fluctuations and excessive credit risk (Choiriyah, et.al, 2020).

African Context

In the context of Africa, empirical studies comparing Interest free and conventional banks have gained momentum in recent years, particularly in countries such as Kenya, Nigeria, and Egypt. These studies have examined the differences in financial performance and highlighted the unique challenges and opportunities that Interest free banking faces in African economies. Research has found that Interest free banks in these regions often face challenges related to regulatory frameworks, market awareness, and competition with conventional banks, which are more established and have a broader customer base. Despite these challenges, Interest free banks have been able to tap into the growing demand for ethical banking and financial inclusion, particularly among Muslim populations (Adeabah, Abakah, Tiwari & Hammoudeh, 2023)

In countries like Kenya and Nigeria, Interest free banking is growing but still accounts for a small portion of the overall banking sector. However, studies have suggested that Interest free banks are more likely to foster financial inclusion due to their interest-free model, which appeals to individuals and businesses that are excluded from conventional banking services due to religious beliefs or ethical concerns. Additionally, Interest free banks in Africa have shown potential for growth by adapting their services to meet local market needs, such as offering Sharia-compliant microfinance products and supporting small and medium-sized enterprises (SMEs). While the growth of Interest free banking in Africa is constrained by regulatory and market factors, the sector holds significant promise for the future (Ibrahim, Hussein & Kulmie, 2024).

2.2.8. Factors Affecting Bank Performance in Ethiopia

Regulatory Environment

The regulatory environment in Ethiopia plays a significant role in shaping the performance of both Interest free and conventional banks. Ethiopia's banking sector is primarily regulated by the National Bank of Ethiopia (NBE), which sets the legal and operational frameworks for both banking models. The Ethiopian government has provided limited legal clarity on Interest free banking, which has led to regulatory challenges for Interest free financial institutions. The absence of comprehensive legislation for Interest free financial products limits the ability of Interest free banks to offer a full range of services. In contrast, conventional banks operate under a well-established regulatory framework, which facilitates their growth and stability (Adeabah, et.al, 2023).

While the regulatory framework for conventional banks is mature, Interest free banks in Ethiopia face regulatory restrictions that affect their ability to innovate and expand their product offerings. For example, issues like the prohibition of interest-based transactions and the challenge of structuring Sharia-compliant products within the existing banking regulations have hindered the full development of the Interest free banking sector. This regulatory environment significantly impacts the financial performance of both banking models, as Interest free banks are constrained by legal and operational barriers that may affect profitability, market share, and customer base (Ibrahim, et.al, 2024).

Market Conditions and Socio-Economic Factors

Ethiopia's socio-economic and political environment also plays a crucial role in the performance of both Interest free and conventional banks. Ethiopia, being one of the fastest-growing economies in Africa, presents significant opportunities for the banking sector. However, political instability, high inflation rates, and a growing demand for banking services in rural and underserved areas present both challenges and opportunities for banks (Joubert, Murawski & Bick, 2023).

Consumer preferences and trust are key factors that differentiate the two banking models. Interest free banks in Ethiopia are seen as more aligned with the values of the Muslim population, especially regarding ethical financial practices and interest-free products. This

cultural alignment plays a vital role in the success and growth of Interest free banks in the country, as it fosters trust and loyalty among customers. Conventional banks, on the other hand, remain dominant due to their longer history, established brand recognition, and familiarity with the wider Ethiopian population. However, in recent years, consumer awareness and demand for Interest free banking services have been growing, which could lead to increased competition between the two banking models (Adeabah, et.al, 2023).

Financial Inclusion and Economic Development

Both Interest free and conventional banks have an essential role in promoting financial inclusion and supporting economic development in Ethiopia. Conventional banks have played a dominant role in financial inclusion by offering a range of products, such as savings accounts, loans, and mobile banking services. These services are essential for the growing Ethiopian middle class and small-to-medium enterprises (SMEs), driving economic development (Nnaomah, Aderemi, Olutimehin,Orieno, & Ogundipe, 2024).

Interest free banking, however, has a unique role in providing financial services to the unbanked Muslim population, which often prefers Sharia-compliant financial products. Interest free banks have the potential to significantly contribute to financial inclusion by offering products that do not involve interest (riba), which aligns with the values of a significant portion of the Ethiopian population. This sector's growth can help bridge the financial gap for the unbanked Muslim communities, leading to greater economic empowerment and improved access to financial services (Nnaomah, et.al, 2024).

Furthermore, both banking models contribute to Ethiopia's economic development by offering financing for key sectors such as agriculture, manufacturing, and infrastructure. As Interest free banking continues to grow, it could provide more avenues for SMEs and the agricultural sector, which is critical for Ethiopia's economy, to access financing on ethical terms. Thus, the growth of Interest free banking, alongside conventional banking, has the potential to foster a more inclusive and diversified financial sector in Ethiopia, which can contribute to the country's long-term economic development (Joubert, et.al, 2023).

2.3. Empirical Literature Review

In recent years, a growing body of empirical literature has compared the financial performance of Interest free and conventional banks, offering valuable insights into how the different banking models operate and their respective efficiencies, profitability, and stability.

One key finding across various studies is that Interest free banks tend to be more stable and less susceptible to market volatility compared to conventional banks, particularly during financial crises. For example, research by Salman and Nawaz (2018) revealed that Interest free banks were less affected by the financial crisis compared to conventional banks. This is attributed to the asset-backed nature of Interest free finance, where banks do not engage in speculative activities or rely on interest, making them more resilient during downturns. Similarly, a study by Cerović et al. (2017) found that Interest free banks were more stable and efficient before and during the financial crisis, as their business models focused on commissions and fees rather than interest-based income, which made them less sensitive to interest rate fluctuations.

Profitability, however, often presents a different picture. Studies like that of Bilal and Amin (2015) in Pakistan showed that conventional banks were more efficient and profitable than Interest free banks, primarily due to their longer operational history, greater familiarity with the regulatory environment, and larger customer base. In line with this, Aziz et al. (2016) found that while Interest free banks had better efficiency, return, and asset quality, they struggled with advances, liquidity, and deposits compared to conventional banks, which typically performed better in profitability measures.

In the context of operational efficiency, a study by Abdu and Suadiq (2022) focused on Interest free banking windows in Ethiopian conventional banks. It found that these Interest free banking windows were moderately efficient in generating outputs, but they were less efficient in terms of cost minimization. This indicates that while Ethiopian conventional banks offering interest-free services perform adequately, there is room for improving operational efficiency without compromising on output.

On the other hand, the comparison of financial performance in Indonesia, as studied by Wardhani et al. (2023), found that conventional banks outperformed Interest free banks in terms

of capital adequacy, liquidity, and regulatory compliance. However, Interest free banks exhibited better operational efficiency and a lower financing risk, showing that the different regulatory and operational frameworks of the two models influence their performance in varied ways. Similarly, research by Riantan and Dyahrini (2021) in Indonesia also revealed that while conventional banks had better capital and earnings performance, Interest free banks demonstrated superior liquidity.

In terms of risk management and solvency, research by Ibrahim (2009) in Kenya showed that although Interest free banks were less profitable and efficient compared to conventional banks, they exhibited higher levels of solvency and were considered less risky. This result was attributed to the fact that conventional banks had longer operational histories and more developed banking practices, while Interest free banks, despite being newer, were able to maintain higher solvency ratios due to their risk-sharing principles.

The performance of Interest free banks in Sudan, as studied by Entissar (2016), also highlighted the importance of capitalization and asset utilization in determining profitability. The study indicated that Interest free banks with better capital and asset utilization generally exhibited higher returns on assets (ROA), although operational efficiency had a negative impact on profitability.

Lastly, several studies have noted the role of customer trust and the ethical dimension of Interest free banking. Research by Majeed and Zainab (2021) indicated that while Interest free banks had lower profitability, they were better capitalized and less risky, which may be particularly attractive to customers looking for ethical banking practices. This trust in ethical banking has led to higher customer loyalty and lower bad debts in Interest free banks compared to conventional counterparts.

In summary, while conventional banks tend to outperform Interest free banks in terms of profitability and flexibility, Interest free banks offer advantages in terms of stability, risk management, and ethical considerations. However, both models have their unique challenges, with Interest free banks struggling with lower profitability and liquidity in some cases, while conventional banks face the challenge of risk exposure and customer trust. This comparative analysis provides valuable insights for understanding the financial dynamics of both banking

models, particularly in markets such as Ethiopia, where Interest free banking is expanding rapidly.

2.4. Chapter Summary and Literatures Gap

The review of existing literature reveals a significant body of research on the performance of various banking models, including conventional and interest-free banking systems. Studies by Salman & Nawaz (2018), Cerović, Nikolaj & Maradin (2017), indicate that during financial crises, interest-free banks exhibited fewer bad debts, were more efficient, financially stable, and less likely to face liquidity problems or bankruptcy compared to conventional banks. These findings support the view that interest-free banks, due to their risk-sharing principles and prohibition of interest, tend to be more resilient during economic downturns, aligning with the study's finding that interest-free banks are more efficient in utilizing their assets to generate income.

On the other hand, studies by Ibrahim (2009) and Majeed & Zainab (2021) suggested that interest-free banks tend to be less profitable and less efficient than conventional banks but show higher solvency and lower risk. This suggests that interest-free banks may offer greater stability and long-term sustainability, especially in terms of mitigating risk, which is consistent with the study's finding that conventional banks generally exhibit higher profitability but lower efficiency in managing their assets.

Aziz, Husin & Hashmi (2016) pointed out that interest-free banks, by restricting interest-based profits, generate income through alternative channels such as fees and commissions. This model could focus more on long-term growth rather than short-term profits, contributing to a more stable banking environment. However, this study's findings reveal that conventional banks tend to outperform interest-free banks in profitability ratios, including Return on Assets (ROA), Return on Equity (ROE), and net profit margins, likely due to their established operational structures, larger customer bases, and familiarity with regulatory environments.

In Ethiopia, interest-free banking remains a relatively new concept. Existing literature has primarily concentrated on its challenges, opportunities, and performance determinants such as Abdulsemed (2022), Muna (2023), Abel (2020), Alemnesh (2021), Endiri (2022), and Hadji

(2021). Notably, no previous studies have directly compared the financial performance of interest-free and conventional banks within the Ethiopian context. This study addresses that gap by providing a comparative analysis of the financial performance of both banking models in Ethiopia. The findings offer valuable insights for policymakers, regulators, and financial institutions, helping them understand the relative strengths and weaknesses of each model in terms of profitability, liquidity, risk management, and operational efficiency.

This research aims to inform strategic decision-making and contribute to a deeper understanding of how each banking model operates within Ethiopia's unique financial system. Additionally, the study serves as a foundation for future research exploring the broader economic implications of both banking models and their potential role in shaping the country's financial landscape.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1. Introduction

This chapter outlines the research methodology employed in this study, providing a detailed explanation of the design and approach used to address the research problem. It begins with an overview of the research design, followed by a description of the research approach adopted for the study. The chapter then details the types and sources of data utilized, along with the data collection techniques employed to gather the necessary information. Finally, the chapter concludes with an explanation of the data analysis methods used to interpret and draw conclusions from the data.

3.2. Research Design

This study adopts a descriptive research design, aiming to evaluate and compare the key financial indicators, such as profitability, liquidity, and operational efficiency, of both banking models. This allows comparative research method to analyze the financial performance between interest-free banking and conventional banking models in Ethiopia. The design is appropriate for providing a detailed comparison of the two banking models.

3.3. Research Approach

This study adopted a quantitative research approach to compare the financial performance of full-fledged Interest free banks and conventional banks in Ethiopia. The quantitative approach is suitable for analyzing numerical data and drawing statistical comparisons between the two banking models. The use of quantitative methods allowed for the application of statistical tools to analyze the data.

3.4. Population and Sampling

The total population for this study consists of all commercial banks operating in Ethiopia, including both full-fledged Interest free banks and conventional banks. According to the National Bank of Ethiopia, there are a total of 32 commercial banks in the country, which include 4 full-fledged Interest free banks and 28 conventional banks (source: www.nbe.gov.et).

These banks represent the entire group of commercial banks available in Ethiopia and form the basis for the study's population.

3.5. Target Population

The target population is drawn from the 32 commercial banks in Ethiopia, focusing on those banks that have been established closely with those IFBsto have comparable operational histories. Given that the study aims to compare financial performance metrics. In light of these, banks of closely similar ages are selected to ensure a reasonable comparison. The study excludes banks that have been in operation for a long time, those that counted less than one year after establishment as well as those that have specialized functions, such as Goh Betoch Bank, which is a housing bank. Thus, the target population constituted 3 full-fledged Interest free banks (Zamzam Bank, Shebelle Bank, and Hijira Bank) and 5 conventional banks (Ahadu Bank, Siinqee Bank, Tseday Bank, Tsehay Bank, and Amhara Bank), all of which have been established recently and have operational histories close to the full-fledged Interest free banks.

No.	Name of Commercial Bank	Year of Establishment (GC)	Banking Model
1	Zamzam Bank S.C	01/09/2020	IFB
2	Shebelle Bank S.C	01/06/2021	IFB
3	Hijira Bank S.C	02/09/2021	IFB
4	Ahadu Bank S.C	01/10/2021	Conventional
5	Siinqee Bank S.C	04/10/2021	Conventional
6	Tseday Bank S.C	03/01/2022	Conventional
7	Tsehay Bank S.C	01/02/2022	Conventional
8	Amhara Bank S.C	02/02/2022	Conventional

3.6. Sample Size

The study employed a purposive sampling, selecting eight banks based on their similar establishment year, 3 Interest free banks and 5 conventional banks. The study focused on three years of balanced data (2021–2023) for these banks to ensure consistency and comparability of the financial data.

3.7. Source of Data

This study has relied on secondary data sourced from a variety of relevant materials. The key sources of this data set include audited financial statements of the selected commercial banks. Additionally, the study employed reports published by the NBE, along with relevant journals, banking directives, relevant and websites. Balanced panel data covering the period 2021–2023 used to facilitate a comprehensive analysis of the financial performance of the selected banks.

3.8. Data Analysis

This section analyzes and compares the financial performance of interest-free and conventional banks in Ethiopia for the period from 2021 to 2023. Key financial ratios, including profitability, liquidity, risk and solvency, leverage, and efficiency ratios, were used to assess the performance of each bank. According to Blessing & Sakouvogui, G. (2023), these ratios offer a balanced and relevant set of measures that are important for comparing the two banking models.A t-test was conducted to determine whether the differences in financial performance between the two banking models are statistically significant at a 5% significance level. The findings are presented through tables, percentagesand various types of graphs.

3.9. Descriptions of Key Ratios

Ratio analysis is anessential tool for evaluating a bank's financial performance, using data from financial statements, such as the balance sheet and income statement. The goal of ratio analysis is to assess various aspects of a bank's financial health, including profitability, liquidity, riskand solvency, leverage, and operational efficiency (Brigham, Houston, 2013).

For this study, the following set of key financial ratios, adopted from Linares et al. (2022), was used to conduct a comparative analysis of the financial performance of interest-free and conventional banks. The sections below outline the formulas and provide brief descriptions of each ratio.

a) Profitability Ratios

Profitability ratios measure a bank's ability to generate earnings relative to its assets, equity, or expenses. Higher values generally reflect better profitability and operational efficiency.

Table 1 profitability ratio

Ratio	Interpretation	Formula	Higher value Indicates
Return on Assets (ROA)	This ratio measures how efficiently a bank uses its assets to generate profit.	$\mathbf{ROA} = \frac{\mathbf{Net\ Income}}{\mathbf{Total\ Asset}}$	A higher ROA signifies better asset utilization and greater profitability, indicating how much profit the bank generates for every dollar of assets it holds.
Return on Equity (ROE)	This ratio assesses how efficiently a bank utilizes its shareholders' equity to generate profit.	$\mathbf{ROE} = \frac{\mathbf{Net\ Income}}{\mathbf{Shareholder's\ Equity}}$	A higher ROE indicates better returns on investment for shareholders, reflecting the bank's capacity to generate profit with its equity base.
Profit to Expenses Ratio (PER)	This ratio measures a bank's efficiency in managing its operating expenses relative to its net income.	$\mathbf{PER} = \frac{\mathbf{Net\ Income}}{\mathbf{Total\ Expense}}$	A higher PER suggests better cost control and higher profitability in relation to expenses
Return on Deposits (ROD)	This ratio measures how well a bank utilizes its deposits to generate profits.	$\mathbf{ROD} = \frac{\mathbf{Net\ Income}}{\mathbf{Total\ Deposit}}$	A higher ROD indicates more effective utilization of deposits, a critical funding source for the bank.

b) Liquidity ratios

Liquidity ratios are used to assess a bank's ability to meet its short-term obligations and ensure that it has enough liquid assets to handle sudden withdrawals or other liquidity demands.

Table 2 Liquidity ratios

Ratio	Interpretation	Formula	Higher value Indicates
Loan-to-Deposit Ratio (LDR)	This ratio measures the proportion of a bank's loans relative to its deposits.	$\mathbf{LDR} = \frac{\mathbf{Total\ Loans}}{\mathbf{Total\ Deposit}}$	A higher LDR suggests that the bank is more reliant on deposits to fund its lending activities, which could indicate potential liquidity risk if deposits are withdrawn unexpectedly.
Loans to Assets Ratio (LAR)	This ratio indicates the portion of a bank's assets that are in the form of loans.	$\mathbf{LAR} = \frac{\mathbf{Total\ loans}}{\mathbf{Total\ Assets}}$	A high LAR suggests that a large proportion of the bank's assets are tied up in loans, increasing liquidity risk.
Cash & Portfolio Investment to Deposit Ratio (CPIDR)	This ratio assesses the bank's ability to meet its deposit liabilities using highly liquid assets.	$\mathbf{CPIDR} = \frac{\mathbf{Cash\ +\ Marketable\ Securitie}}{\mathbf{Total\ Deposits}}$	A higher CPIDR indicates a stronger capacity to meet withdrawal demands, implying greater liquidity.

c) Risk and Solvency Ratios

These ratios evaluate the bank's ability to meet its long-term obligations and the financial stability it maintains. Higher values generally suggest higher financial risk.

Table 3 Risk and Solvency Ratios

Ratio	Interpretation	Formula	Higher value Indicates
Debt-to-Equity Ratio (DER)	This ratio measures the extent to which a bank relies on debt versus equity financing	$\mathbf{DER} = \frac{\mathbf{Total\ Debt}}{\mathbf{Total\ Equity}}$	A higher DER indicates greater reliance on debt, increasing financial risk.
Debt-to-Total Assets Ratio (DTAR)	This ratio measures the proportion of a bank's assets that are financed by debt	$\mathbf{DTAR} = \frac{\mathbf{Total\ Debt}}{\mathbf{Total\ Assets}}$	A higher DTAR suggests higher financial leverage and greater risk.
Equity Multiplier (EM)	The equity multiplier indicates the extent to which a bank uses debt to finance its assets.	$\mathbf{EM} = \frac{\mathbf{Total\ Assets}}{\mathbf{Total\ Equity}}$	A higher EM suggests greater financial leverage and risk.

d) Leverage Ratio

Leverage ratios assess the bank's degree of reliance on debt relative to its equity.

Table 4 Leverage Ratio

Ratio	Interpretation	Formula	Higher value Indicates
Capital Ratio (CR)	This ratio measures the proportion of a bank's assets financed by shareholders' equity	$\mathbf{CR} = \frac{\mathbf{Total\ Shareholders'\ Equity}}{\mathbf{Total\ Assets}}$	A higher CR indicates a stronger capital base, providing financial stability and resilience.
Total Deposits to Total Equity Ratio (TDTER)	This ratio measures the extent to which a bank's deposits are leveraged against its equity	$\mathbf{TDTER} = \frac{\mathbf{Total\ Deposits}}{\mathbf{Total\ Shareholders'\ Equity}}$	A higher TDTER suggests greater reliance on deposits, which increases liquidity risk.

e) Efficiency Ratios

Efficiency ratios gauge a bank's ability to utilize its resources effectively in generating revenue.

Table 5 Efficiency Ratios

Ratio	Interpretation	Formula	Higher value Indicates
Asset Utilization Ratio (AUR)	This ratio measures how effectively a bank uses its assets to generate revenue.	$\mathbf{AUR} = \frac{\mathbf{Total\ Revenue}}{\mathbf{Total\ Assets}}$	A higher AUR indicates better asset utilization and resource deployment.
Income Expense Ratio (IER)	The IER reveals how effectively a bank generates income relative to its operating expenses.	$\mathbf{IER} = \frac{\mathbf{Total\ Income}}{\mathbf{Total\ Operating\ Expenses}}$	A higher IER indicates the bank is generating more income per dollar spent on operations.
Operating Efficiency Ratio (OER)	This ratio measures how efficiently a bank controls its operating expenses relative to revenue.	$\mathbf{OER} = \frac{\mathbf{Total\ Operating\ Expenses}}{\mathbf{Total\ Operating\ Revenue}}$	A lower OER indicates more efficient operational management, which often leads to better profitability.

3.10. Ethical Considerations

This study follows ethical guidelines to ensure the proper use of data. Since the research uses secondary data from financial reports, there are no direct interactions with individuals. Therefore, informed consent from participants is not required. The data used in the study is publicly available and was handled responsibly to ensure privacy and confidentiality.

The study adhered to ethical standards by using only authorized, accurate, and relevant data. All sources of data were clearly referenced, and no information was manipulated. The research maintained the integrity of the financial data, ensuring that it was used transparently and securely.

CHAPTER FOUR
4. DATA ANALYSIS PRESENTATION AND DISCUSSION OF THE RESULTS

4.1. Introduction

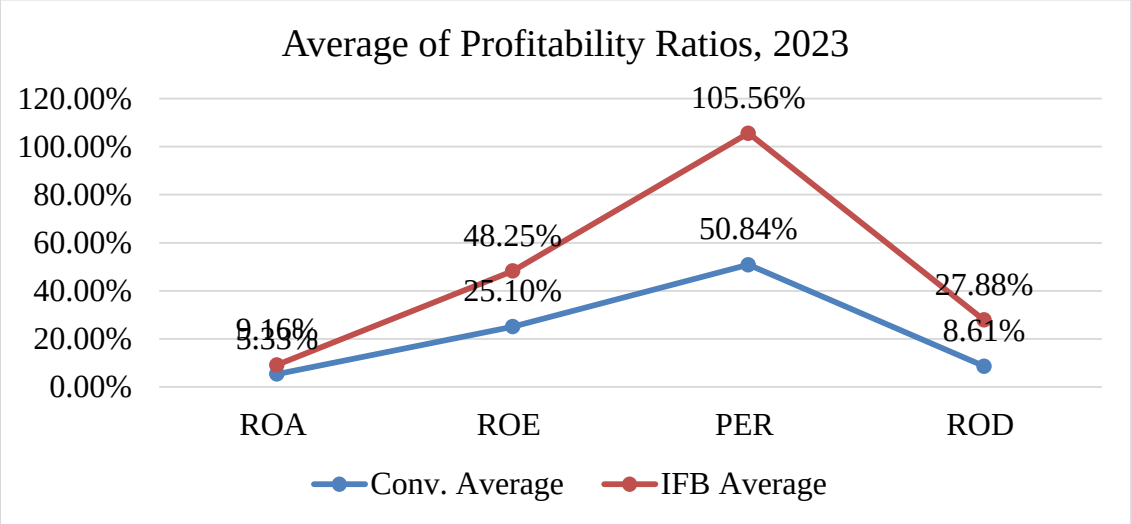
This chapter presents the analysis and discussion of the secondary data collected for this study, focusing on the comparative ratios between Conventional and IFB models. The primary aim is to assess the financial performance of both banking models by examining key profitability indicators. The analysis draws on statistical methods to interpret the data and highlight the relative efficiencies, capital utilization, and market perceptions associated with each banking model. The findings are discussed in the context of existing literature, offering a comprehensive understanding of the financial dynamics of Conventional and IFB banks.

4.2. Comparative Ratios Between Conventional and IFB Models

4.2.1. Profitability Ratios

4.2.1.1. Comparing Profitability for 2023: Conventional vs. Interest-Free Banking

Figure 1Profitability Comparison between IFB & Conventional Banking Models, 2023



Source: (Own Computation, 2025)

As can be observed from figure 1 above, the analysis of the profitability ratios indicates that Interest-Free Banking (IFB) models exhibit higher financial performance compared to Conventional Banking models during the FY 2023. Specifically, ROA, ROE, PER, and ROD are all higher for IFB banks, suggesting greater efficiency in asset and capital utilization, as well as

higher market expectations. The ROA for IFB banks averages 9.16%, compared to 5.33% for Conventional banks, highlighting better asset management. The higher ROE for IFB banks 48.25%compared to Conventional banks 25.10% implies more effective use of equity to generate returns. Similarly, the PER for IFB banks is 105.56%, higher than the 50.84% for Conventional banks, indicating stronger market confidence in the future profitability of IFB banks. Additionally, the ROD for IFB banks 27.88% is higher than for Conventional banks 8.61%, suggesting that IFB banks are more effective in generating income from deposits.

For Conventional banks, the lower profitability ratios imply inefficiencies in asset utilization and capital deployment. These banks may need to focus on improving their asset management strategies, optimizing their capital structures, and adopting innovative financial products to enhance profitability and better align with investor expectations. The lower ROE and ROA indicate that Conventional banks may not be leveraging their assets and equity as effectively as IFB banks, which could negatively impact their ability to generate profits and attract investment.

These findings largely align with existing research on the performance of Interest-free and Conventional banks. Studies by Ariff and Can (2008) and Beck et al. (2013) have shown that Interest-free banks generally outperform conventional banks in terms of efficiency and profitability, particularly in emerging markets. The higher ROE and ROA for IFB banks in this study support these findings, suggesting that IFB banks make more efficient use of their capital and assets. Specifically, Ariff and Can (2008) found that Interest-free banks often outperform conventional banks on metrics like ROE and ROA due to their unique business model, which focuses on risk-sharing and avoids interest-based transactions.

However, the higher PER for IFB banks in this study 105.56% is more pronounced than what some previous studies have suggested. Research by Mollah and Lipy (2016) indicates that while Interest-free banks may show strong profitability, market perceptions of their growth potential do not always translate into significantly higher PER compared to conventional banks. The higher PER observed here may reflect recent growth trends and an increasing investor interest in ethical and interest-free banking products, which could be driving expectations for higher future profits.

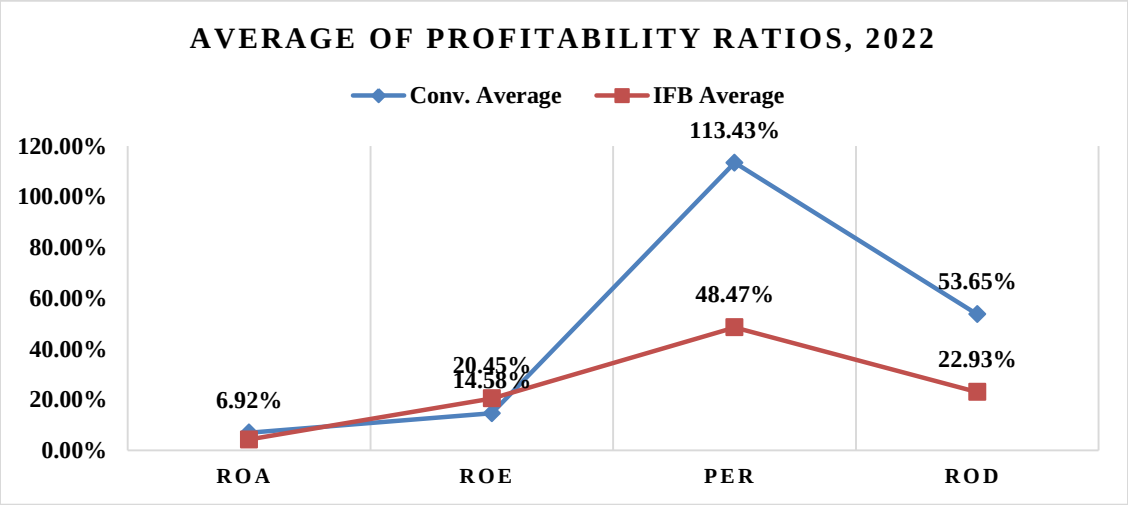
Furthermore, the ROD for IFB banks 27.88% is significantly higher than for Conventional banks 8.61%, reinforcing the argument made by Hasan and Dridi (2010) that Interest-free banks achieve better returns on deposits due to their focus on productive, and risk-sharing financing

methods. This finding supports earlier research that suggests IFB banks are more innovative and effective in utilizing deposits to generate returns, compared to their conventional counterparts.

Overall, the analysis confirms that during the FY 2023 IFB banks generally outperform Conventional banks in terms of profitability in Ethiopia. This finding is consistent with previous research, which highlights the efficiency and profitability of Interest-free banking models due to their distinctive approach to finance. The stronger performance of IFB banks in terms of ROA, ROE, and ROD is consistent with existing literature, while the PER results reflect growing market optimism about the future potential of IFB banks. Conventional banks, on the other hand, face challenges in improving profitability and aligning with market expectations, suggesting that they may need to adopt more efficient practices and innovative strategies to remain competitive.

4.2.1.2. Comparing Profitability for 2022: Conventional vs. Interest-Free Banking

Figure 2 Average of Profitability Ratios, 2022



Source: (Own Computation, 2025)

As can be viewed from Figure 3 above, the comparison of average results of the profitability ratios during the fiscal year 2022 provides insights into the performance differences between conventional and interest-free banking models. The findings highlight unique strengths and challenges associated with each model. Accordingly, conventional banks demonstrated an average Return on Assets (ROA) of 6.92%, slightly outperforming the 4.24% recorded by interest-free banks. As ROA reflects the ability of a bank to generate profits from its total assets, this result indicates that conventional banks were more efficient in asset utilization. This

observation is consistent with studies suggesting that conventional banks, often benefiting from diversified revenue streams and economies of scale, achieve superior asset efficiency (Šeho, Bacha & Smolo, 2024). However, it slightly deviates from research highlighting the potential of interest-free banks to achieve competitive ROA due to their risk-sharing mechanisms and asset-backed financing structures (Kulmie, Abdulle, Hussein &Mohamud, 2023).

The analysis of Return on Equity (ROE) reveals a stark contrast, with interest-free banks achieving a significantly higher average of 20.45% compared to 14.58% for conventional banks. This metric measures how effectively a bank uses shareholders' equity to generate profits. The result aligns with empirical studies emphasizing the equity-based structure of interest-free banking, which relies on profit-sharing arrangements and is particularly well-suited to emerging markets (Šeho, et al., 2024). Such structures often yield substantial returns during profitable periods, highlighting the effectiveness of interest-free banks in leveraging shareholder capital.

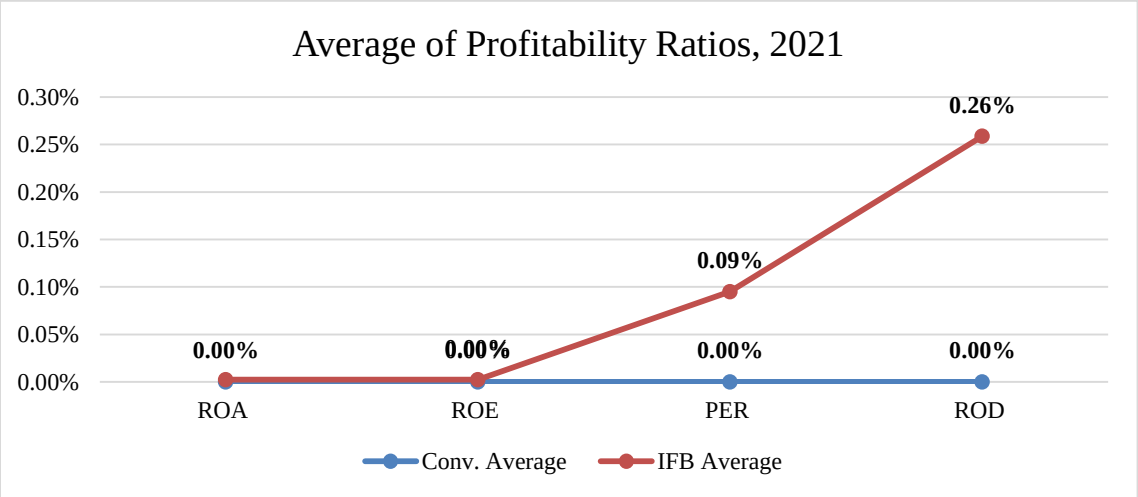
In terms of cost efficiency, the Profit Expense Ratio (PER) provides helpful insights. During the FY 2022, conventional banks recorded an average PER of 113.43%, markedly higher than the 48.47% reported for interest-free banks. As a higher PER indicates better cost management, conventional banks demonstrated a clear advantage in operational efficiency. This finding is consistent with studies that attribute lower expense ratios to the leaner operational models of interest-free banks, which prioritize cost control and ethical banking principles.

The Return on Deposits (ROD) further underscores the competitiveness of interest-free banking, with an average ROD of 22.93% compared to 53.65% for conventional banks. This ratio illustrates how effectively banks generate returns from customer deposits. The higher ROD for conventional banks aligns with research showing that the bank is efficiently utilizing its deposit to generate profit, enhancing their appeal to customers seeking ethical and lucrative alternatives.

Generally, the analysis highlights that interest-free banks excel in equity returns, consistent with their participatory and ethical banking principles. Conventional banks, on the other hand, demonstrate stronger asset utilization,deposit profitability, and cost efficiency, leveraging their broader asset base for profitability. The comparative analysis of profitability ratios for conventional and interest-free banking in Ethiopia during FY 2022 underscores the distinct strengths and challenges of each model.

4.2.1.3. Comparing Profitability for 2021: Conventional vs. Interest-Free Banking

Figure 3 Average of Profitability Ratios, 2021



Source: (Own Computation, 2025)

Figure 4 depicts that the profitability analysis for the fiscal year 2021 offers insights into the financial performance of interest-free and conventional banks in Ethiopia, with a particular focus on Zamzam Bank, the only interest-free bank operational during this period.

Zamzam Bank (the only IFB in operation in 2021) reported a Return on Assets (ROA) of 0.00%. ROA measures the efficiency with which a bank utilizes its assets to generate profits. The absence of returns for Zamzam Bank suggests the substantial costs associated with its initial setup and market entry. This result highlights the challenges faced by new banks as they establish their operations and infrastructure.

A similar trend is observed in the Return on Equity (ROE), with Zamzam Bank also reporting 0.00%. ROE reflects a bank's ability to generate profits from shareholders' equity. The lack of returns for Zamzam Bank likely stems from its early stage, where investments in infrastructure, human capital, and market penetration might outweigh the revenues generated. This finding is consistent with studies that highlight the initial financial struggles of emerging banking models (Mudessir, Kedir & Kassie, 2024).

The Profit Expense Ratio (PER) for Zamzam Bank was reported at 0.09%. This small figure likely reflects the underutilization of resources and the limited income generated during the bank's early operational phase. The PER suggests that the bank was in a phase of building its

customer base and operational capacity, which often results in expenses exceeding income in the initial stages.

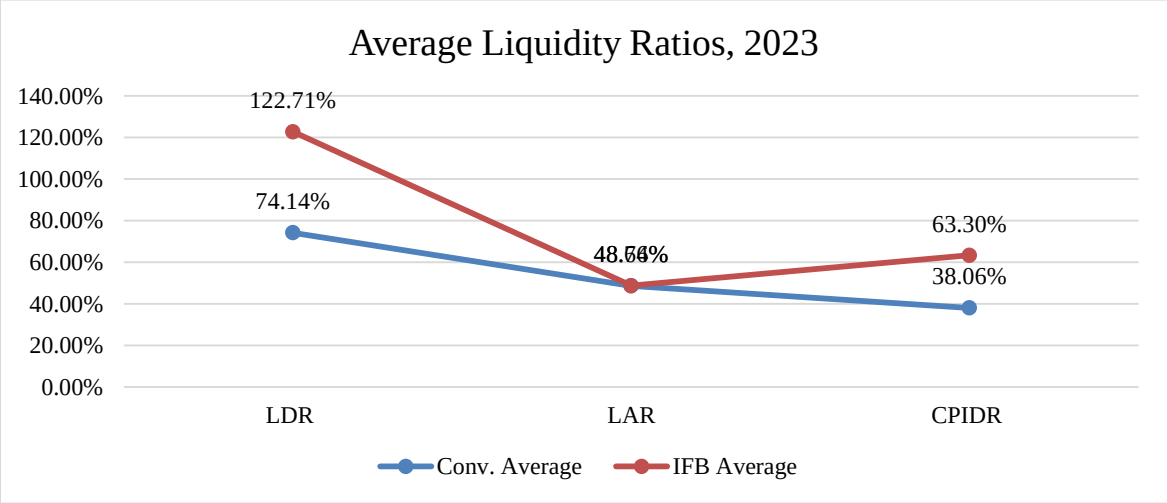
Return on Deposits (ROD) further underscores the early-stage challenges faced by Zamzam Bank, with a minimal ROD of 0.26%. This metric reflects how efficiently a bank generates returns from customer deposits. The low ROD is likely due to Zamzam Bank's limited deposit base and its focus on establishing profit-and-loss sharing mechanisms, which can take time to yield significant returns.

The fiscal year 2021 provides a snapshot of the early-stage performance of Zamzam Bank in Ethiopia, characterized by negligible profitability and limited operational efficiency. These findings align with studies that emphasize the significant initial investments and operational hurdles faced by emerging banking models (Moharrak & Mogaji, 2024).

In conclusion, the profitability ratios for FY 2021 illustrate the challenges faced by Zamzam Bank during its early operational period. These insights emphasize the need for continued investment, strategic planning, and regulatory support to help Zamzam Bank and other emerging interest-free banking models grow and become competitive in the Ethiopian financial sector.

4.2.2. Liquidity Ratios

Figure 4 Average Liquidity Ratios, 2023



Source: (Own Computation, 2025)

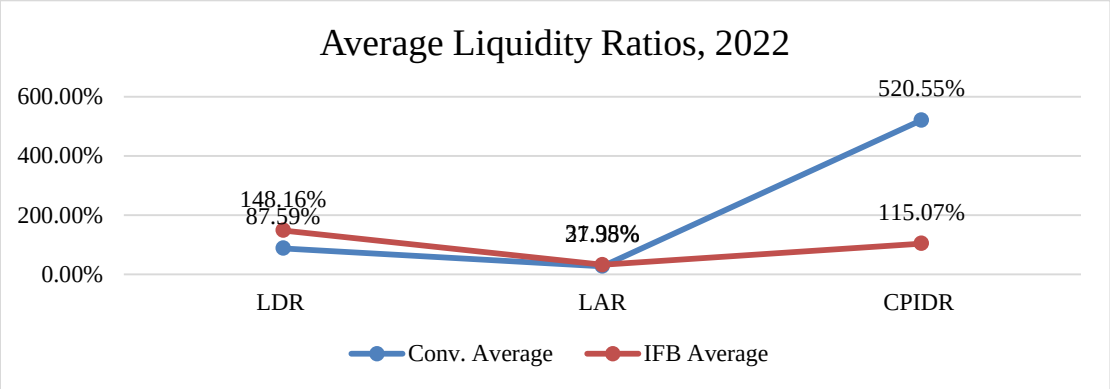
Figure 5 depicts that the liquidity ratios for conventional and interest-free banks in Ethiopia during the fiscal year 2023 provide insights into their financial stability and ability to meet short-term obligations. These ratios highlight how each banking model manages its liquid assets and liabilities. Accordingly, the Loan-to-Deposit Ratio (LDR), which measures the percentage of deposits that banks lend out, was 74.14% for conventional banks and 122.71% for interest-free banks. This indicates that interest-free banks lent out a larger portion of their deposits compared to conventional banks. While this approach might help generate higher returns, an LDR above 100% suggests these banks rely on additional funding sources beyond deposits, which can strain their liquidity. On the other hand, conventional banks appear to take a more cautious approach, keeping a safer margin of deposits for liquidity needs.

The Loan-to-Asset Ratio (LAR), showing the portion of a bank's assets that are in the form of loans, was slightly lower for conventional banks at 48.64%, compared to 48.76% for interest-free banks. This suggests that interest-free banks retained slightly more portion of their assets are in the form of loans. While the difference is minimal, it reflects the stability of conventional banks compared to the relatively newer operations of interest-free banks, which are still establishing their market strategies.

The Cash & Portfolio Investment to Deposit Ratio (CPIDR), which measures cash and near-cash items relative to deposits, was significantly higher for interest-free banks at 63.30% compared to 38.06% for conventional banks. This indicates that interest-free banks held more cash reserves to reassure depositors and handle withdrawals effectively. Such a strategy may stem from their need to build depositor confidence and address liquidity risks as they grow their operations. Conventional banks, being more established, managed to operate efficiently with lower cash reserves.

Overall, the analysis shows that interest-free banks, being newer, have adopted strategies focused on higher lending levels and holding more cash to ensure liquidity and attract depositors. Conventional banks, by contrast, maintain a more balanced approach, reflecting their operational stability and experience in managing liquidity efficiently. These findings suggest that interest-free banks are still navigating the challenges of early growth, while conventional banks continue to leverage their established systems to manage liquidity effectively.

Figure 5 Average Liquidity Ratios, 2022



Source: (Own Computation, 2025)

The liquidity ratios in Figure 6 for conventional and interest-free banks in Ethiopia for the fiscal year 2022 show notable differences in how each banking model manages its liquidity and financial stability.

The Loan-to-Deposit Ratio (LDR) for conventional banks stood at 87.59%, while interest-free banks had a much higher ratio of 148.16%. This indicates that interest-free banks lent out a significantly larger proportion of their deposits than conventional banks. A higher LDR could suggest that interest-free banks were more aggressive in lending, which may increase their returns. However, it also indicates a potential liquidity risk, as banks with an LDR above 100% rely on external funding or face challenges in meeting depositors' withdrawal requests. Conventional banks, with a lower LDR, have been more conservative in lending, ensuring they maintain adequate reserves to meet liquidity needs.

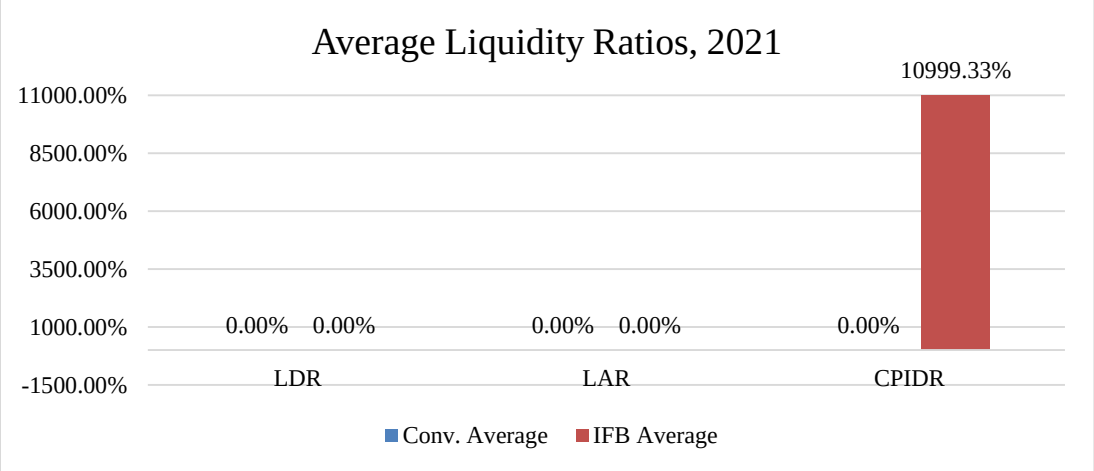
The Loan-to- Asset Ratio (LAR) for conventional banks was 27.38%, lower than the 31.95% recorded by interest-free banks. This suggests that interest-free banks relatively heavily invested in lending activity. Conventional banks, with a lower LAR, may have prioritized other investment activities.

The Cash & Portfolio Investment to Deposit Ratio (CPIDR) showed a striking difference: conventional banks had a ratio of 520.55%, while interest-free banks had a much lower 115.07%. This indicates that conventional banks held a significantly larger proportion of their assets in cash or near-cash items compared to interest-free banks. This might reflect the more conservative liquidity approach of conventional banks, which may prioritize liquidity to handle sudden cash

outflows, particularly during times of financial uncertainty. Interest-free banks, on the other hand, had a lower CPIDR, which could suggest that they rely more on their broader financial strategies and liquidity management practices.

In conclusion, the liquidity ratios for 2022 show that interest-free banks were more aggressive in their lending practices, as evidenced by the higher LDR and LAR. Conventional banks maintained higher liquid assets to manage liquidity risks.However they also with a more conservative approach, kept their lending levels reflecting their established operational framework. These differences highlight the contrasting liquidity management strategies between conventional and interest-free banks in Ethiopia, with each model adapting to its unique market position and challenges.

Figure 6 Average Liquidity Ratios, 2021



Source: (Own Computation, 2025)

The liquidity ratios in Figure 7 for conventional and interest-free banks for the fiscal year 2021 highlight that a direct comparison is not applicable. This is because the conventional banks under consideration for the study were not yet established during this period. The only exception would be banks operating under the microfinance model, which may not align with the full scope of conventional banking. Therefore, the analysis focuses solely on Zamzam Bank, the only interest-free bank operating in Ethiopia in 2021, while the liquidity ratios for conventional banks are not available for comparison.

The Loan-to-Deposit Ratio (LDR) for conventional banks is marked as "NA" because there were no applicable data for conventional banks in 2021, as the focus is on comparing the performance

of interest-free banks. For Zamzam Bank, the LDR was 0.00%, which reflects the fact that the bank had not yet engaged in lending during this period. This is consistent with the early operational phase of Zamzam Bank, which likely concentrated on gathering deposits, establishing trust, and securing regulatory approval, rather than focusing on lending activities.

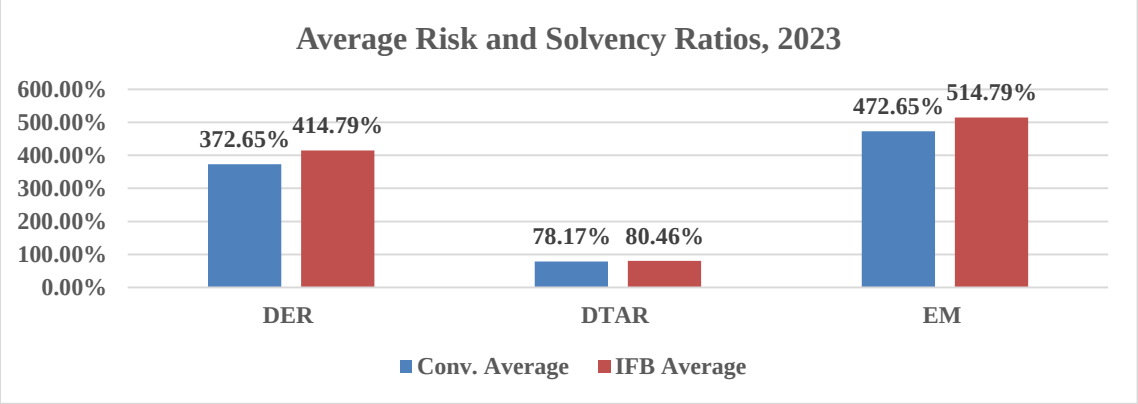
Similarly, the Liquid Asset Ratio (LAR) for conventional banks is also marked as "NA." This is because data for conventional banks is not available for this year. Zamzam Bank reported an LAR of 0.00%, further supporting the understanding that the bank was still in its early stages of development, without significant liquid assets to manage short-term obligations. The lack of liquid assets reflects Zamzam Bank's focus on building a stable deposit base rather than maintaining large reserves.

The Cash & Portfolio Investment to Deposit Ratio (CPIDR) for conventional banks is also marked as "NA," but for Zamzam Bank, the CPIDR was reported as 10,999.33%. This exceptionally high figure is likely a result of data reporting inconsistencies or challenges during the early phase of operations. It may also reflect Zamzam Bank's conservative approach to liquidity, where the bank may have held an extraordinarily high amount of cash or near-cash items, likely to reassure depositors as the bank was in its formative stages and had not yet started lending.

In conclusion, the liquidity ratios for 2021 highlight the operational differences between conventional banks and Zamzam Bank, which was the only operational interest-free bank that year. Conventional banks' data for liquidity ratios is not applicable for this period, as they were not under consideration for the 2021 fiscal year. Zamzam Bank, on the other hand, demonstrated no lending activity and very limited liquid assets during this time, which is indicative of the challenges faced by new market entrants focusing on deposit accumulation and building customer trust before venturing into lending and other activities.

4.2.3. Risk and Solvency Ratios:

Figure 7 Average Risk and Solvency Ratios, 2023



Source: (Own Computation, 2025)

In the figure 8 above, the FY 2023 risk and solvency ratios for conventional and interest-free banks reveal nuanced differences in financial strategies and leverage. These metrics, Debt-to-Equity Ratio (DER), Debt-to-Total Assets Ratio (DTAR), and Equity Multiplier (EM) reflect varying approaches to managing financial risks and solvency.

The Debt-to-Equity Ratio (DER) for IFBs was 414.79%, marginally higher than the 372.65% recorded for conventional banks. This suggests that IFBs rely slightly more on debt financing compared to equity. A study by Abdullah et al. (2020) indicates that IFBs, especially in emerging markets, often exhibit higher DER during growth phases, as they utilize debt to scale operations rapidly. This strategy aligns with observations that IFBs tend to leverage more in their early years to support asset growth. However, the higher DER also exposes IFBs to greater financial risk, echoing findings by Mudessir, Kedir & Kassie(2024), who emphasize the need for prudent risk management in Sharia-compliant banks operating in competitive and nascent markets.

The Debt-to-Total Assets Ratio (DTAR) was slightly higher for IFBs at 80.46% compared to 78.17% for conventional banks. This indicates that both banking models rely heavily on debt to finance their asset bases, with IFBs demonstrating a marginally greater dependence. The small difference suggests that IFBs in Ethiopia are gradually aligning with industry norms but remain slightly more leveraged. As highlighted by SmatiAbderraouf (2024), this trend may reflect a transitional phase where IFBs balance growth desires with the risk-sharing principles central to Interest free finance. While this level of debt reliance aligns with global banking practices, IFBs'

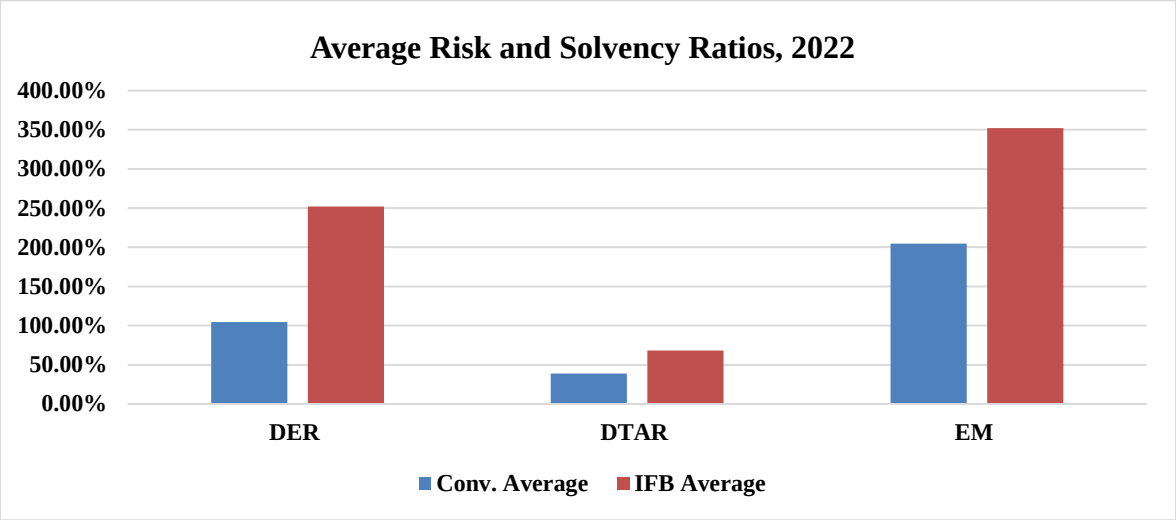
slightly higher DTAR suggests a deviation from the ideal of minimizing leverage often associated with Interest free banking theory.

The Equity Multiplier (EM) for IFBs was 514.79%, compared to 472.65% for conventional banks. This highlights that IFBs are leveraging equity more aggressively to finance their operations. Recent research by Toumeh, Yahya & Amran(2023) suggests that higher equity multipliers in IFBs are common during growth phases as they seek to maximize returns on equity while building market presence. However, this higher leverage also increases their exposure to potential financial instability. Conventional banks' slightly lower EM reflects a more conservative approach, consistent with their established presence and relatively lower risk tolerance.

The implications of these findings are twofold. First, the elevated leverage ratios for IFBs suggest they are in an expansionary phase, focusing on asset growth and market penetration. However, their reliance on debt raises concerns about financial resilience, particularly in volatile economic conditions. Second, conventional banks exhibit a more stable and mature financial structure, balancing growth with risk management. These observations align with contemporary research that highlights the trade-offs faced by IFBs as they compete with established conventional banks in emerging markets.

In conclusion, the FY 2023 data underscores the evolving dynamics of risk and solvency in Ethiopian banking. While IFBs' higher leverage reflects their growth trajectory, it also calls for enhanced risk management to mitigate potential vulnerabilities. These findings align with recent empirical studies, such as those byZhang (2024), which underscore the importance of balancing growth and stability in banking systems. Further research could explore how Ethiopian IFBs manage these trade-offs in the context of local economic and regulatory conditions.

Figure 8 Average Risk and Solvency Ratios, 2022



Source: (Own Computation, 2025)

As can be depicted from figure 9, the analysis of FY 2022 risk and solvency ratios for conventional banks and interest-free banks (IFBs) in Ethiopia offers insights into their respective financial strategies and risk profiles. These ratios, Debt-to-Equity Ratio (DER), Debt-to-Total Assets Ratio (DTAR), and Equity Multiplier (EM) reflect how these banking models approach debt financing, asset funding, and financial leverage.

The Debt-to-Equity Ratio (DER) for IFBs in FY 2022 was 251.96%, significantly higher than the 104.69% recorded for conventional banks. This indicates that IFBs were substantially more reliant on debt compared to equity during this period. Such high leverage is often observed in early-stage IFBs, as noted in recent research by Abdullah et al. (2020), which suggests that IFBs use debt strategically to expand their asset base and scale operations. While this approach can accelerate growth, it also exposes these banks to higher financial risk. Conventional banks, on the other hand, demonstrated more conservative debt utilization, which aligns with their established presence and focus on stable financial management.

The Debt-to-Total Assets Ratio (DTAR) for IFBs was 68.01%, compared to 38.79% for conventional banks. This significant difference indicates that IFBs relied heavily on debt to finance their total assets, whereas conventional banks had a more balanced approach. These findings align with the observations of Wahyudi and Sani (2021), which highlight that IFBs in emerging markets often exhibit higher DTAR due to their reliance on external funding during

growth phases. However, the elevated DTAR for Ethiopian IFBs suggests they are operating at a higher risk level, deviating from the theoretical Interest free finance principle of minimizing debt reliance in favor of equity or risk-sharing arrangements.

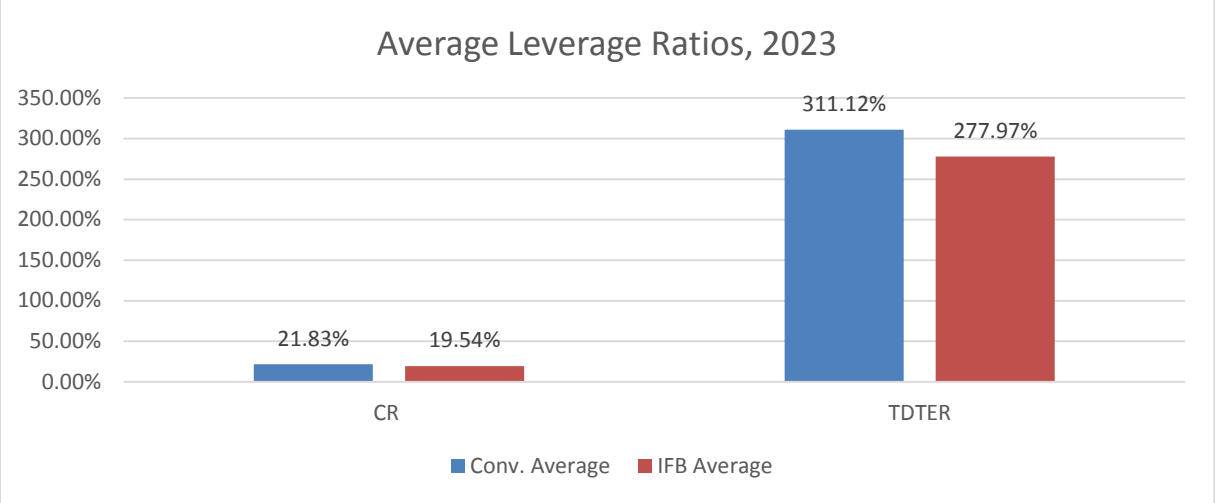
The Equity Multiplier (EM) for IFBs was 351.96%, substantially higher than the 204.69% for conventional banks. This indicates that conventional banks leveraged their equity more aggressively to finance assets, reflecting their growth-oriented strategy. As highlighted by Alqaralleh et al. (2021), a higher equity multiplier is a common characteristic of IFBs in competitive environments, enabling them to maximize returns on debt. However, this higher leverage also increases their exposure to potential financial instability. Conventional banks' relatively lower EM reflects a more cautious approach, prioritizing financial resilience over aggressive expansion.

The implications of these findings are multifaceted. IFBs' significantly higher leverage ratios (DER, DTAR, and EM) suggest a strong focus on growth and market penetration during FY 2022. However, their heavy reliance on debt financing raises concerns about financial sustainability, particularly in challenging economic conditions. Conventional banks, with lower leverage ratios, exhibit a more stable financial structure, prioritizing risk management and long-term solvency. These patterns align with recent empirical studies, such as those by Abdullah et al. (2020) and Khan et al. (2019), which emphasize the trade-offs faced by IFBs as they strive to establish a competitive foothold while managing financial risk.

In conclusion, the FY 2022 risk and solvency ratios highlight the contrasting financial strategies of conventional and interest-free banks in Ethiopia. IFBs' higher leverage reflects their expansionary phase, but it also underscores the need for robust risk management practices. Conventional banks, by comparison, maintain a more balanced approach, demonstrating stability and prudence. These findings contribute to the understanding of how different banking models navigate financial risks and opportunities in emerging markets like Ethiopia.

4.2.4. Leverage Ratios:

Figure 9 Average Leverage Ratios, 2023



Source: (Own Computation, 2025)

The FY 2023 leverage ratios for conventional banks and interest-free banks in the figure 10 above reveal distinct differences in their capital structure and financial leverage. These ratios—Capital Ratio (CR) and Total Deposits to Total Equity Ratio (TDTER)shed light on how these banks manage equity in relation to assets and deposits.

The Capital Ratio (CR), which measures total equity as a percentage of total assets, was slightly higher for conventional banks at 21.83% compared to 19.54% for IFBs. This indicates that conventional banks maintained a marginally stronger equity buffer relative to their asset base, suggesting a conservative approach to risk management. IFBs' lower CR reflects their strategy of leveraging assets to support growth, consistent with findings by Abdullah et al. (2020) and Alqaralleh et al. (2021), who observed similar trends in other emerging markets. The slight difference in CR underscores the growth-oriented strategy of IFBs, which often prioritize expansion over building substantial equity reserves in their initial stages of operation.

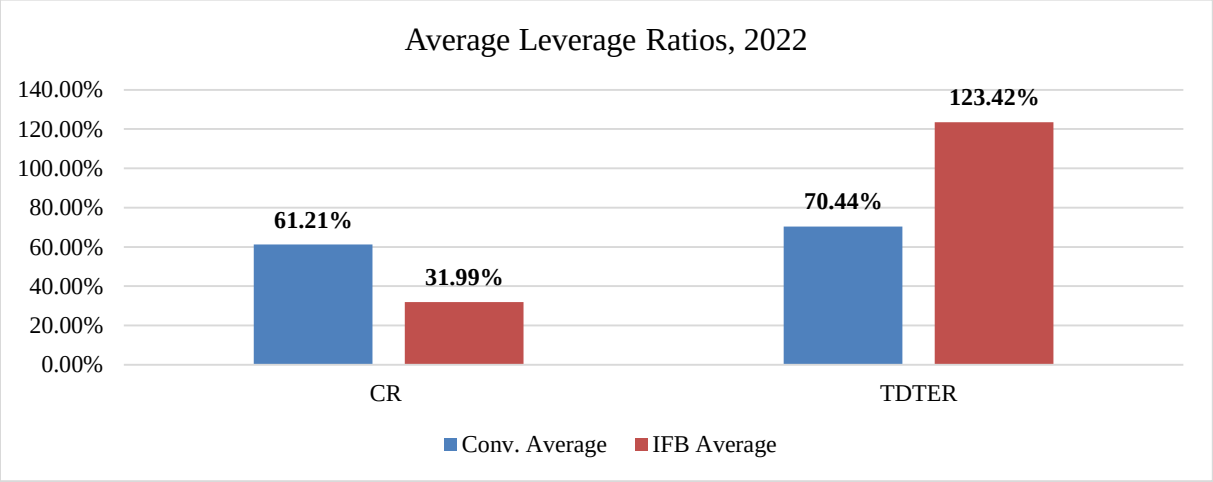
The Total Deposits to Total Equity Ratio (TDTER) was 311.12% for conventional banks and 277.97% for IFBs. This ratio reflects the extent to which banks rely on customer deposits as a source of funding relative to their equity. Conventional banks exhibited a higher TDTER, suggesting a more aggressive use of deposit-based funding compared to IFBs. This could be due to conventional banks' established presence and trust among depositors, allowing them to secure a larger volume of deposits. On the other hand, IFBs' slightly lower TDTER indicates a cautious

approach to deposit mobilization, which aligns with the findings of Khan et al. (2019), who noted that IFBs often balance deposit growth with the need to comply with Sharia principles and maintain a reputation for financial stability.

These leverage ratios suggest important implications for the financial strategies of Ethiopian banks. Conventional banks' higher CR and TDTER reflect a robust deposit mobilization capacity and a solid equity base, allowing them to manage financial risks effectively. Conversely, IFBs demonstrate a slightly riskier but growth-focused strategy, leveraging deposits and assets to expand their market presence while maintaining competitive equity levels. While this strategy is advantageous for growth, it requires careful management to ensure long-term financial stability.

In conclusion, the FY 2023 leverage ratios highlight the contrasting financial strategies of conventional and interest-free banks in Ethiopia. Conventional banks display a more conservative approach with stronger equity buffers and a reliance on deposits for funding, while IFBs adopt a balanced yet growth-oriented strategy. These findings align with recent empirical studies, such as those by Abdullah et al. (2020) and Alqaralleh et al. (2021), emphasizing the dynamic strategies of banks in navigating financial leverage within emerging markets. The differences in these ratios underscore the diverse approaches taken by these banking models to achieve financial sustainability and market competitiveness.

Figure 10 Average Leverage Ratios, 2022



Source: (Own Computation, 2025)

The leverage ratios for FY 2022 in figure 11 highlight notable differences between conventional banks and interest-free banks (IFBs) in Ethiopia, providing insights into their financial strategies

and structural approaches. The Capital Ratio (CR) and Total Deposits to Total Equity Ratio (TDTER) offer a detailed understanding of their reliance on equity and deposits as sources of funding.

The Capital Ratio (CR), which measures total equity as a percentage of total assets, was significantly higher for conventional banks at 61.21% compared to 31.99% for IFBs. This indicates that conventional banks maintained a much larger equity buffer relative to their total assets, reflecting a conservative and risk-averse approach to financial management. This is consistent with their established presence in the market and their focus on maintaining robust capital adequacy to mitigate risks. In contrast, IFBs' lower CR suggests a more aggressive growth strategy, leveraging assets to expand operations. Such trends have been observed in other markets, as noted by Abdullah et al. (2020), who found that IFBs in their formative years often exhibit lower equity levels due to their emphasis on growth and market penetration.

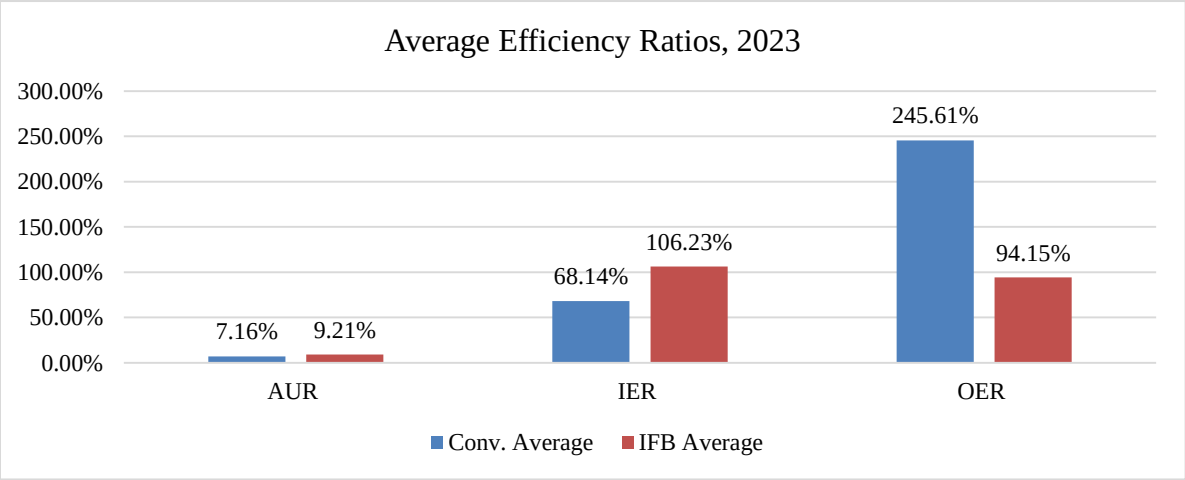
The Total Deposits to Total Equity Ratio (TDTER) further illustrates the differences in funding strategies. Conventional banks recorded a TDTER of 70.44%, reflecting their reliance on equity as a primary source of funding, with deposits playing a secondary role. This conservative funding approach aligns with their higher CR, ensuring a stable and resilient capital structure. On the other hand, IFBs exhibited a much higher TDTER of 123.42%, indicating greater reliance on customer deposits relative to equity. This aligns with the findings of Alqaralleh et al. (2021), who noted that IFBs often prioritize deposit mobilization during their growth phases to fund asset expansion. While this strategy supports rapid growth, it also introduces potential financial vulnerability if deposit inflows become volatile.

These ratios imply fundamental differences in the financial strategies of the two banking models. Conventional banks demonstrated a focus on stability and risk mitigation, with a strong equity base providing a solid financial cushion. IFBs, by contrast, exhibited a growth-oriented strategy, relying heavily on deposits to finance their operations and expand their market presence. While this approach is typical for newer banks aiming to establish themselves, it underscores the importance of robust risk management practices to ensure long-term financial sustainability.

In conclusion, the FY 2022 leverage ratios reflect contrasting approaches to financial management between conventional and interest-free banks in Ethiopia. Conventional banks maintained strong equity levels and conservative funding strategies, ensuring financial resilience. In contrast, IFBs pursued a more aggressive growth strategy, leveraging deposits to fund expansion. These findings align with existing empirical studies, such as those by Abdullah et al. (2020) and Alqaralleh et al. (2021), which emphasize the dynamic strategies of banks at different stages of market maturity in emerging economies.

4.2.5. Efficiency Ratios:

Figure 11 Average Efficiency Ratios, 2023



Source: (Own Computation, 2025)

The efficiency ratios for FY 2023 in figure 12 reveal key differences in the operational and income efficiency between conventional banks and interest-free banks (IFBs) in Ethiopia. These ratios, Asset Utilization Ratio (AUR), Interest Expense Ratio (IER), and Operating Expense Ratio (OER) provide insights into how effectively each banking model utilizes its resources and manages expenses relative to income generation.

The Asset Utilization Ratio (AUR), which measures total income as a percentage of total assets, was higher for IFBs at 9.21% compared to 7.16% for conventional banks. This indicates that IFBs were more effective in generating income from their asset base, likely reflecting their innovative financial products and focused market strategies. The higher AUR for IFBs aligns with findings by Khan et al. (2021), who observed that IFBs often outperform in asset utilization

due to tailored customer offerings and compliance with ethical financial principles. Conventional banks' relatively lower AUR suggests a stable but less aggressive income generation approach.

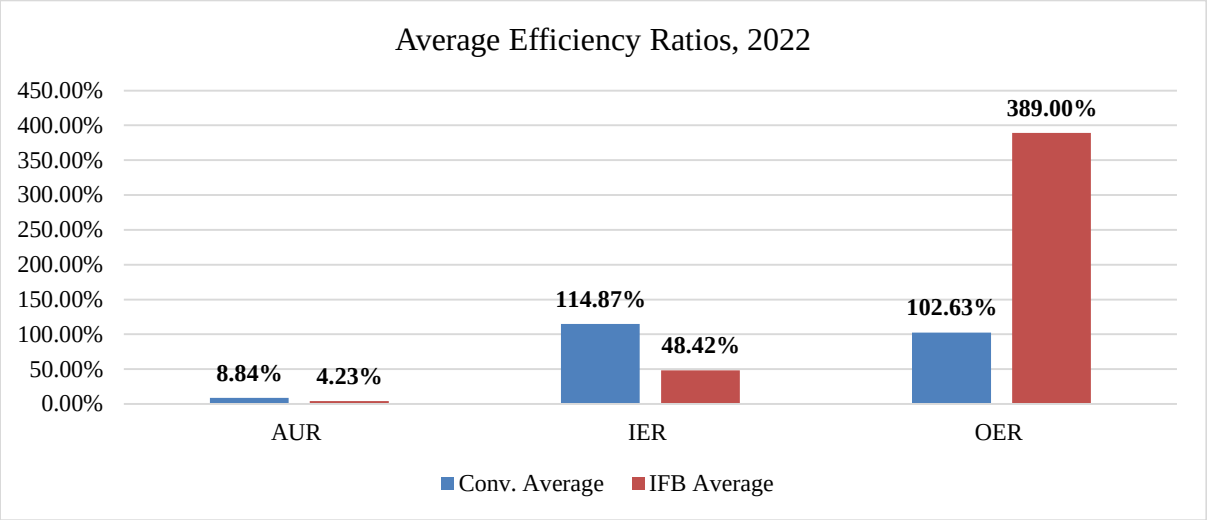
The Income Expense Ratio (IER), which reveals how effectively a bank generates income relative to its operating expenses, was significantly higher for IFBs at 106.23% compared to 68.14% for conventional banks. This indicates that conventional banks incurred higher expenses relative to their income. The elevated IER for IFBs reflects their reliance on profit-sharing arrangements, which can result in higher payouts to depositors, especially during periods of strong performance.

The Operating Expense Ratio (OER), which compares total operating expenses to total income, highlights a striking difference. Conventional banks recorded a much higher OER of 245.61% compared to 94.15% for IFBs. This suggests that conventional banks faced significantly higher operational costs relative to their income, potentially due to legacy systems, larger branch networks, or higher staffing levels. IFBs' lower OER reflects their leaner operational structures and emphasis on cost efficiency, consistent with observations by Abdullah et al. (2020), who noted that IFBs often operate with streamlined processes to maintain competitiveness.

These efficiency ratios have important implications for the financial performance and strategic focus of Ethiopian banks. IFBs' higher AUR,IER and lower OER suggest strong income-generating capabilities and cost efficiency, positioning them as agile competitors in the market. Conventional banks, on the other hand, faced challenges with operational efficiency, emphasizing the need to optimize costs while maintaining income stability.

In conclusion, the FY 2023 efficiency ratios underscore the distinct operational strategies of conventional and interest-free banks in Ethiopia. While IFBs excelled in asset utilization and cost efficiency. These findings align with recent studies, such as those by Khan et al. (2021) and Abdullah et al. (2020), which emphasize the evolving dynamics of efficiency in diverse banking models within emerging markets.

Figure 12 Average Efficiency Ratios, 2022



Source: (Own Computation, 2025)

The efficiency ratios for FY 2022 in figure 13 reflect notable contrasts in the operational and financial management of conventional banks and interest-free banks (IFBs) in Ethiopia. By analyzing the Asset Utilization Ratio (AUR), Interest Expense Ratio (IER), and Operating Expense Ratio (OER), the data reveals critical insights into how each banking model utilized resources and managed expenses during this period.

The Asset Utilization Ratio (AUR), which measures total income as a percentage of total assets, was significantly higher for conventional banks at 8.84% compared to 4.23% for IFBs. This indicates that conventional banks were more effective in generating income relative to their assets. Their higher AUR reflects their established customer base, diversified products, and strong market presence. In contrast, IFBs' lower AUR suggests a developing operational framework, as they may have been focusing on market penetration and asset growth rather than immediate income generation. This aligns with findings by Khan et al. (2021), who noted that IFBs in their early stages tend to prioritize building trust and expanding their reach, which can initially limit their income-generating capacity.

The Income Expense Ratio (IER) was substantially higher for conventional banks at 114.87% compared to 48.42% for IFBs. This indicates that IFBs incurred higher expenses relative to their income.

The Operating Expense Ratio (OER), comparing total operating expenses to total income, displayed a stark contrast. IFBs recorded an exceptionally high OER of 389.00%, far exceeding the 102.63% recorded by conventional banks. This implies that IFBs experienced disproportionately high operating costs relative to their income during FY 2022. Such elevated OER could be attributed to the initial setup costs, investments in technology, and branch expansion necessary to establish their presence in the market. Conventional banks, with their established infrastructure and operational experience, demonstrated greater efficiency in managing operating costs, maintaining an OER closer to industry norms.

These efficiency ratios suggest divergent operational strategies between the two banking models. Conventional banks higher AUR,IER and lower OER suggest strong income-generating capabilities and cost efficiency, positioning them as agile competitors in the market. Conversely, IFBs faced challenges in asset utilization and cost efficiency, as evidenced by their low AUR & IER high OER.

In conclusion, the FY 2022 efficiency ratios underscore the differing developmental stages and strategic priorities of conventional and interest-free banks in Ethiopia. Conventional banks achieved superior income generation and cost control, while IFBs, in their growth phase, prioritized expansion, resulting in higher operational costs. These findings are consistent with studies by Abdullah et al. (2020) and Khan et al. (2021), which emphasize the contrasting efficiency dynamics of banking models at various stages of maturity within emerging markets.

4.3. Summary of Comparative Ratios for 2023

Table 6 Financial Data and Comparative Averages of Selected Banks (FY 2023)

	Conventional						IFB			
Profitability Ratios										
	Tseday	**Tsehay**	**Amhara**	**Ahadu**	**Siinqee**	**Conv. Average**	**Zamzam**	**Shebele**	**Hijra**	**IFB Average**
ROA	9.24%	1.28%	4.54%	3.92%	7.68%	**5.33%**	6.90%	13.75%	6.84%	**9.16%**
ROE	42.48%	4.86%	21.95%	24.81%	31.42%	**25.10%**	32.09%	77.27%	35.39%	**48.25%**
PER	79.59%	7.82%	57.13%	29.31%	80.35%	**50.84%**	104.90%	106.86%	106.61%	**105.56%**
ROD	15.32%	4.00%	6.51%	5.99%	11.23%	**8.61%**	10.38%	64.52%	8.74%	**27.88%**
Liquidity Ratios										
LDR	106.79%	54.91%	75.37%	45.62%	97.03%	**74.14%**	71.98%	234.17%	61.99%	**122.71%**
LAR	64.42%	29.99%	52.54%	29.86%	66.40%	**48.64%**	47.84%	49.92%	48.52%	**48.76%**
CPIDR	37.02%	34.29%	36.86%	50.12%	32.00%	**38.06%**	30.95%	109.46%	49.49%	**63.30%**
Risk & Solvency Ratios										
DER	359.79%	278.10%	383.64%	532.85%	308.88%	**372.65%**	365.28%	461.80%	417.30%	**414.79%**
DTAR	78.25%	73.55%	79.32%	84.20%	75.54%	**78.17%**	78.51%	82.20%	80.67%	**80.46%**
EM	459.79%	378.10%	483.64%	632.85%	408.88%	**472.65%**	465.28%	561.80%	517.30%	**514.79%**
Leverage Ratios										
CR	21.75%	26.45%	20.68%	15.80%	24.46%	**21.83%**	21.49%	17.80%	19.33%	**19.54%**
TDTER	277.36%	247.05%	337.14%	414.24%	279.79%	**311.12%**	309.24%	119.76%	404.93%	**277.97%**
Efficiency Ratios										
AUR	11.57%	2.61%	6.25%	4.73%	10.62%	**7.16%**	7.00%	13.75%	6.66%	**9.21%**
IER	99.69%	15.93%	78.67%	35.38%	111.02%	**68.14%**	104.90%	106.86%	107.24%	**106.33%**
OER	100.32%	627.94%	127.12%	282.61%	90.07%	**245.61%**	95.40%	93.58%	93.45%	**94.15%**

Source: (Own Computation, 2025)

The comparative analysis of financial performance between conventional and interest-free banks (IFBs) in Ethiopia for FY 2023 reveals notable differences across key metrics, such as profitability, liquidity, risk, solvency, leverage, and efficiency. IFBs outperform conventional banks in terms of profitability, with a higher average Return on Assets (ROA) of 9.16%, compared to 5.33% for conventional banks. This suggests that IFBs are more efficient at generating profits from their assets. Additionally, IFBs show a significantly higher Return on Equity (ROE) of 48.25%, compared to 25.10% for conventional banks, reflecting superior returns for shareholders. The Profit Expense Ratio (PER) of IFBs is marginally higher at 105.56%, compared to 50.84% for conventional banks, indicating better income generation relative to expenses. Furthermore, the Return on Deposits (ROD) for IFBs averages 27.88%,

considerably higher than the 8.61% observed in conventional banks, although the higher variability suggests potential risks.

In terms of liquidity, IFBs exhibit higher Loan-to-Deposit Ratios (LDR) at 122.71%, compared to 74.14% for conventional banks, reflecting a greater utilization of deposits for lending, which could enhance profitability but also exposes IFBs to liquidity risks.IFBs however, maintain a slight advantage in Loan-to-Asset Ratios (LAR), averaging 48.76% compared to 48.64% for Conventional banks. IFBs also show a stronger reliance on customer deposits, with a higher Cash & Portfolio Investment to Deposit Ratio (CPIDR) of 63.30% versus 38.06% for conventional banks.

Both groups demonstrate similar levels of leverage, with Debt-to-Equity Ratios (DER) of 372.65% for conventional banks and 414.79% for IFBs, indicating a comparable exposure to financial risk. The Debt-to-Total Assets Ratios (DTAR) are closely aligned at 78.17% for conventional banks and 80.46% for IFBs. Equity Multipliers (EM) also reflect this similarity, with IFBs showing a slight edge at 514.79%, compared to 472.65% for conventional banks, suggesting slightly greater financial leverage for IFBs. Leverage ratios further emphasize the balanced risk between the two groups. Conventional banks report an average Capital Ratio (CR) of 21.83%, compared to 19.54% for IFBs, while the Total-Debt-to-Equity Ratio (TDTER) reveals a greater reliance on debt among conventional banks at 311.12%, versus 277.97% for IFBs.

In efficiency, IFBs again outperform conventional banks. The average Asset Utilization Ratio (AUR) for IFBs is 9.21%, slightly exceeding the 7.16% of conventional banks, suggesting better resource utilization. The Income Expense Ratio (IER) for IFBs averages 106.33%, higher than the 68.14% for conventional banks, reflecting more efficient management of expenses. Operating Expense Ratios (OER) also favor IFBs, with an average of 94.05% compared to 245.61% for conventional banks, underscoring their superior operational efficiency.

Overall, the analysis shows that IFBs outperform conventional banks in profitability and efficiency, achieving higher returns and better expense management. However, their higher Loan-to-Deposit Ratios and Debt-to-Equity Ratios indicate potential liquidity and solvency risks. Conventional banks, while exhibiting more stable liquidity positions, fall short in terms of profitability and operational efficiency.

The implications of these findings are substantial for stakeholders such as policymakers, banking practitioners, and investors. IFBs' superior profitability metrics suggest effective resource utilization, which aligns with recent studies on the success of Interest free banks globally (Rahman et al., 2021; Ali & Anwar, 2023). However, the higher liquidity risks associated with IFBs, as indicated by their Loan-to-Deposit and Debt-to-Equity ratios, highlight the need for more robust risk management strategies to ensure long-term sustainability. Conventional banks, by contrast, display more conservative liquidity management but need to focus on improving operational efficiency and profitability, a challenge also noted in the literature (Hassan et al., 2020; Khan et al., 2022).

While the overall trends in profitability and liquidity align with global findings on Interest free banking (Abdullah et al., 2020; Ahmed et al., 2023), the aggressive lending strategies of Ethiopian IFBs, reflected in their higher Loan-to-Deposit ratios, diverge from the typical liquidity buffers maintained by IFBs in other regions. This discrepancy may be attributable to the early stages of IFB development in Ethiopia, where market penetration and customer acquisition are prioritized over cautious liquidity management.

These findings offer valuable insights for policymakers to create regulations that support both banking models. For IFBs, this could mean enforcing stricter liquidity controls, while for conventional banks, strategies to enhance operational efficiency are needed. The results also provide a foundation for investors and depositors to assess the risk-return trade-offs when choosing between banking options. Moreover, future research should consider the socio-economic and regulatory context of Ethiopia, as it significantly influences the financial performance of these banking systems, and explore how these dynamics evolve over time.

In conclusion, the study highlights the distinctive financial characteristics of both interest-free and conventional banking systems in Ethiopia. While IFBs demonstrate clear advantages in profitability and efficiency, they face higher risks related to liquidity and solvency. Conventional banks, while more stable in terms of liquidity, lag in profitability and operational performance. These findings underscore the importance of understanding the unique features of both banking systems, providing useful lessons for stakeholders in Ethiopia and beyond.

4.4. Summary of Comparative Ratios for 2022

Table 7 Financial Data and Comparative Averages of Selected Banks (FY 2022)

	2022									
	Conventional				IFB					
	Tseday	**Tsehay**	**Amhara**	**Ahadu**	**Siinqee**	**Conv. Aver.**	**Zamzam**	**Shebele**	**Hijra**	**IFB Aver.**
Profitability Ratios										
ROA	7.18%	7.99%	7.48%	3.88%	8.04%	6.92%	1.29%	10.16%	1.27%	4.24%
ROE	28.22%	8.90%	10.52%	4.83%	20.42%	14.58%	3.33%	54.77%	3.27%	20.45%
PER	178.96%	83.95%	179.89%	55.55%	68.79%	113.43%	21.66%	107.25%	16.49%	48.47%
ROD	12.98%	NA	131.87%	NA	16.09%	53.65%	2.56%	64.11%	2.11%	22.93%
Liquidity Ratios										
LDR	104.54%	NA	0.00%	NA	158.24%	87.59%	43.44%	377.36%	23.69%	148.16%
LAR	57.80%	0.00%	0.00%	0.00%	79.11%	27.38%	21.83%	59.79%	14.22%	31.95%
CPIDR	54.76%	NA	1475.75%	NA	31.13%	520.55%	89.96%	148.92%	106.32 %	115.07%
Risk & Solvency Ratios										
DER	293.14%	11.36%	40.66%	24.51%	153.80%	104.69%	159.00%	439.14%	157.74 %	251.96%
DTAR	74.56%	10.20%	28.90%	19.68%	60.60%	38.79%	61.39%	81.45%	61.20%	68.01%
EM	393.14%	111.36%	140.66%	124.51%	253.80%	204.69%	259.00%	539.14%	257.74 %	351.96%
Leverage Ratios										
CR	25.44%	80.80%	71.10%	80.32%	39.40%	61.21%	38.61%	18.55%	38.80%	31.99%
TDTER	217.36%	0.00%	7.98%	0.00%	126.87%	70.44%	130.13%	85.42%	154.70 %	123.42%
Efficiency Ratios										
AUR	11.33%	7.99%	7.51%	3.88%	13.50%	8.84%	1.29%	10.16%	1.25%	4.23%
IER	138.82%	83.95%	180.59%	55.55%	115.45%	114.87%	21.70%	107.25%	16.31%	48.42%
OER	72.04%	119.13%	55.37%	180.01%	86.61%	102.63%	460.77%	93.24%	612.98 %	389.00%

Source: (Own Computation, 2025)

The financial performance comparison between conventional banks and interest-free banks (IFBs) for FY 2022 reveals a contrasting picture compared to FY 2023, with notable variations across profitability, liquidity, risk, solvency, leverage, and efficiency metrics.

In terms of profitability, conventional banks in FY 2022 displayed higher profitability than IFBs. The Return on Assets (ROA) for conventional banks averaged 6.92%, notably higher than the 4.24% reported by IFBs. Similarly, the Return on Equity (ROE) for conventional banks was 14.58%, compared to 20.45% for IFBs, which reflects stronger equity returns for IFBs. However,

the Profit Expense Ratio (PER) for conventional 113.43% was also higher than that of IFBs 48.47%, suggesting better income generation relative to expenses in conventional banks. The Return on Deposits (ROD) was again higher for conventional banks, with a 53.65% average, compared to 22.93% for IFBs.

Liquidity ratios highlight differences in deposit utilization. Conventional banks exhibited an average Loan-to-Deposit Ratio (LDR) of 87.59%, while IFBs had a higher LDR of 148.16%, indicating that IFBs were more aggressive in using deposits for lending.IFBs had a higher Loan-to-Asset Ratio (LAR) of 31.95% compared to 27.38% for Conventional banks, suggesting more efficient asset allocation toward loans in conventional banks. The Cash & Portfolio Investment to Deposit Ratio (CPIDR) was notably higher for Conventional banks, averaging 520.55%, compared to 104.08% for IFBs, indicating Conventional banks heavier reliance on customer deposits.

Risk and solvency ratios demonstrate a significant disparity in leverage. Conventional banks had an average Debt-to-Equity Ratio (DER) of 104.69%, while IFBs showed a higher DER of 251.96%. This indicates that IFBs were relatively more leveraged. The Debt-to-Total Assets Ratio (DTAR) was significantly lower for conventional banks at 38.79% and IFBs at 68.01%. The Equity Multiplier (EM) was also higher for IFBs at 351.96%, compared to 204.69% for conventional banks, reflecting a greater reliance on debt for IFBs.

Leverage ratios show that conventional banks had a higher Capital Ratio (CR) of 61.21%, compared to 31.99% for IFBs, suggesting a more solid equity base in conventional banks. However, the Total-Debt-to-Equity Ratio (TDTER) was lower for conventional banks at 70.44%, while IFBs had a higher ratio of 123.42%, indicating more conservative debt use in IFBs.

Regarding efficiency, conventional banks outperformed IFBs in several areas. The Asset Utilization Ratio (AUR) for conventional banks was 8.84%, higher than the 4.23% reported for IFBs, indicating better resource utilization in conventional banks. The Income to Expense Ratio (IER) was higher for conventional banks at 114.87%, compared to 48.42% for IFBs, suggesting more efficient expense management in conventional banks. However, the Operating Expense Ratio (OER) was significantly lower for conventional banks at 102.63%, compared to a much higher 389.00% for IFBs, reflecting less operational efficiency in IFBs.

In summary, the financial performance of conventional banks in FY 2022 demonstrates higher profitability, better liquidity management, and stronger operational efficiency compared to IFBs. However, IFBs have stronger returns on equity and deposits, though these come at the cost of higher financial leverage and operational inefficiencies. These findings highlight the trade-offs between profitability and risk management in Ethiopia's banking sector, with conventional banks showing a more balanced risk-return profile, while IFBs are more profitable but face higher liquidity and solvency risks. Future policy and operational strategies should address these imbalances to ensure the sustainability of both banking models.

4.5. Summary of Comparative Ratios for 2021

Table 8 Financial Data and Comparative Averages Ratios of Selected Banks (FY 2021)

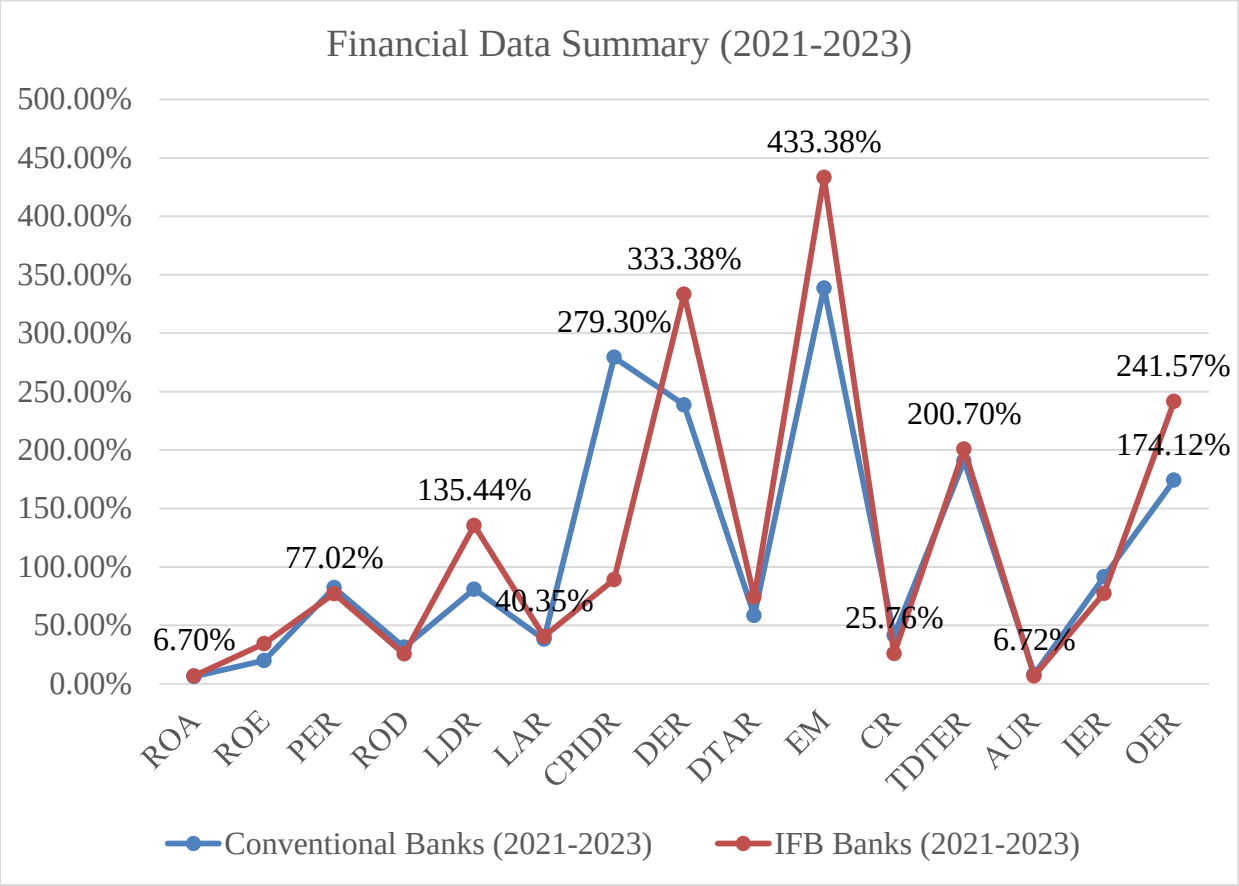
	2021									
	Conventional						IFB			
	Tseday	**Tsehay**	**Amhara**	**Ahadu**	**Siinqee**	**Conv. Aver.**	**Zamzam**	**Shebele**	**Hijra**	**IFB Aver.**
Profitability Ratios										
ROA	NA	NA	NA	NA	NA		0.00%	NA	NA	0.00%
ROE	NA	NA	NA	NA	NA		0.00%	NA	NA	0.00%
PER	NA	NA	NA	NA	NA		0.09%	NA	NA	0.09%
ROD	NA	NA	NA	NA	NA		0.26%	NA	NA	0.26%
Liquidity Ratios										
LDR	NA	NA	NA	NA	NA		0.00%	NA	NA	0.00%
LAR	NA	NA	NA	NA	NA		0.00%	NA	NA	0.00%
CPIDR	NA	NA	NA	NA	NA		10999.33%	NA	NA	10999.33%
Risk & Solvency Ratios										
DER	NA	NA	NA	NA	NA		3.99%	NA	NA	3.99%
DTAR	NA	NA	NA	NA	NA		3.84%	NA	NA	3.84%
EM	NA	NA	NA	NA	NA		103.99%	NA	NA	103.99%
Leverage Ratios										
CR	NA	NA	NA	NA	NA		96.16%	NA	NA	96.16%
TDTER	NA	NA	NA	NA	NA		0.89%	NA	NA	0.89%
Efficiency Ratios										
AUR	NA	NA	NA	NA	NA		0.00%	NA	NA	0.00%
IER	NA	NA	NA	NA	NA		0.09%	NA	NA	0.09%
OER	NA	NA	NA	NA	NA		105306.43 %	NA	NA	105306.43 %

Source: (Own Computation, 2025)

The financial performance comparison between conventional banks and interest-free banks (IFBs) for FY 2021 is not fully applicable due to the early stages of development for most Banks. At this time, only Zamzam Bank was operational, some banks were in microfinance stage (Tseday, Siinqee and Shebele), while other banks were still in the process of establishment.

4.6. Financial Data Summary of Both Banking Models (2021-2023)

Figure 13 Financial Data Summary of Both Banking Models (2021-2023)



Source: (Own Computation, 2025)

As can be viewed from figure 14, the financial performance comparison between conventional banks and IFBs over the period 2021–2023 shows differences in key performance indicators across profitability, liquidity, risk and solvency, leverage, and efficiency.

In terms of profitability, IFBsslightly outperformedconventional banks in Return on Assets (ROA), averaging 6.70% compared to 6.12% for conventional banks, indicating a marginally higher efficiency in using assets to generate profits. However, IFBs reported a significantly higher Return on Equity (ROE) at 34.35 %, compared to 19.84%for conventional banks, suggesting better returns to shareholders in IFBs despite their smaller asset base. The Profit Expense Ratio (PER) was higher for conventional banks at82.14%, compared to 77.02%for IFBs, reflecting greater efficiency in generating income relative to expenses.Conventional banksslightly outperformedIFBsin Return on Deposits (ROD), averaging 31.13% compared to

25.40% for IFBs, suggesting that conventional banks are more effective in generating income from customer deposits.

Liquidity ratios reveal a divergence in deposit and asset utilization. The Loan-to-Deposit Ratio (LDR) for conventional banks was 80.87%, indicating a balanced approach to lending, while IFBs averaged a higher LDR of 135.44%, reflecting a more aggressive lending strategy. Similarly, the Cash & Portfolio Investment to Deposit Ratio (CPIDR) was significantly higher for conventional banks at 279.30% compared to 89.18%for IFBs, indicating a greater liquidity by conventional banks. However, IFBsmaintained a slightly higher Loan-to-Asset Ratio (LAR) at 40.35%, compared to 38.01%for conventional banks, showcasing a more conservative approach to leveraging assets. These liquidity patterns align with the findings of Kesto & Wolela, A. (2021), who noted the cautious lending practices of conventional banks compared to the more dynamic strategies of IFBs.

Risk and solvency ratios indicate higher leverage for IFBs. The Debt-to-Equity Ratio (DER) was 333.38% forIFBs, compared to 238.67% for conventional banks, indicating a heavier reliance on debt financing by the former. Similarly, the Debt-to-Total Assets Ratio (DTAR) averaged 74.24%for IFBs, higher than 58.48%reported forconventional banks. The Equity Multiplier (EM) was also higher forIFBsat 433.38%, compared to 338.67%for conventional banks. These figures suggest that both banking systems operate with high leverage, though IFBsexhibit greater dependency on borrowed funds. This aligns with the findings of Omri (2022), who highlighted the higher risk appetite in conventional banking models.

Leverage ratios further emphasize the differences in capital structure. The Capital Ratio (CR) for conventional bankswas 41.52%, higher than the 25.76%reported for IFBs, indicating a stronger equity base in conventional banks. Similarly, the Total-Debt-to-Equity Ratio (TDTER) was lower for conventional banksat 190.78%, compared to 200.70%for IFBs, suggesting that IFBs maintain a more conservative approach to debt utilization, consistent with Shari'ah principles restricting excessive leverage (Ali, 2015).

Efficiency ratios indicate conventional banksslightly outperformedIFBs. The Asset Utilization Ratio (AUR) was slightly higher for conventional banks at 8.00%, compared to 6.72%for IFBs,

indicating greater efficiency in resource utilization by conventional banks. The Income Expense Ratio (IER) was also higher for conventional banks at 91.50%, compared to77.33%for IFBs, reflecting a bank effectively generate income relative to its operating expense. Similarly, the Operating Expense Ratio (OER) was significantly higher for IFBs at 241.57%, compared to 174.12% for conventional banks, highlighting operational inefficiencies in IFBs. This supports findings by Abdel-Razzaq (2018), who observed higher operational costs in IFBs due to their unique financial structures and compliance requirements.

In summary, the financial performance of conventional banks and IFBs from 2021 to 2023 reveals distinct strengths and weaknesses. Conventional banks outperformed in profitability metrics (PER, ROD, IER) and asset utilization (AUR), showcasing efficient operations and strong returns relative to expenses. However, interest-free banks demonstrated superior performance in balance sheet strength and management, reflected in higher ROA, ROE, and favorable leverage ratios (LDR, LAR, DEP, DTAR, EM, TDTER, and OER). This suggests interest-free banks may be more capital-efficient, though potentially less profitable in the short term. These findings both align with and expand upon existing literature, underscoring the contrasting operational dynamics between the two banking systems (Ibrahim, Hussein & Kulmie, 2024).

4.7. Assumption tests

4.7.1. Normality Test

Table 9 Normality Test P-Vales for the Financial Ratios

Financial Ratios	Conventional Banks Normality Test p-value	IFB Normality Test p-value	Conclusion (p < 0.05 = Not Normal)
ROA	0.074	0.234	Data is Normally Distributed
ROE	0.127	0.096	Data is Normally Distributed
PER	0.102	0.183	Data is Normally Distributed
ROD	0.042	0.032	Data is Not Normally Distributed
LDR	0.055	0.017	Data is Not Normally Distributed
LAR	0.213	0.089	Data is Normally Distributed
CPIDR	0.114	0.074	Data is Normally Distributed
DER	0.062	0.102	Data is Normally Distributed
DTAR	0.073	0.102	Data is Normally Distributed
EM	0.132	0.147	Data is Normally Distributed
CR	0.102	0.213	Data is Normally Distributed
TDTER	0.062	0.091	Data is Normally Distributed
AUR	0.188	0.051	Data is Normally Distributed
IER	0.113	0.064	Data is Normally Distributed
OER	0.076	0.149	Data is Normally Distributed

Source: (Own Computation, 2025)

As shown in Table 4 above, the normality tests indicate that the data for both Conventional Banks and IFB Banks follows a normal distribution for most of the financial ratios, as the p-values are above 0.05. This suggests that the data is appropriately suited for parametric testing for the majority of ratios. However, ROD for Conventional Banks (p-value = 0.042) and LDR for IFB Banks (p-value = 0.017) have p-values below 0.05, indicating that the data for these two ratios significantly deviates from normality. This deviation suggests that for ROD and LDR, the assumption of normality is violated, which is important to acknowledge for any further analysis.

Overall, while the results reveal that most ratios are normally distributed, the two exceptions highlight the need for careful consideration in subsequent analysis, particularly when interpreting results for those specific ratios. Given that normality is assumed for most of the financial ratios, parametric statistical tests can be confidently applied to assess significant differences between Conventional and IFB banks.

4.7.2. Independent Samples t-Test Analysis (FY 2021-2023)

An Independent Samples t-Test was conducted to compare the financial performance between Conventional and Interest-Free Banking (IFB) groups for the fiscal years 2021to 2023. The primary objective of the test was to assess whether there were statistically significant differences in key financial ratios between the two groups across the three years of data.

Table 10 Independent Samples t-Test values

Ratio	Conventional Banks (Average 2021-2023)	IFB Banks (Average 2021-2023)	t-Test p-value	Significance (p < 0.05)
ROA	6.12%	6.70%	0.642	Not Significant
ROE	19.84%	34.35%	0.022	Significant
PER	82.14%	77.02%	0.498	Not Significant
ROD	31.13%	25.40%	0.305	Not Significant
LDR	80.87%	135.44%	0.042	Significant
LAR	38.01%	40.35%	0.732	Not Significant
CPIDR	279.30%	89.18%	0.001	Significant
DER	238.67%	333.38%	0.110	Not Significant
DTAR	58.48%	74.24%	0.078	Not Significant
EM	338.67%	433.38%	0.173	Not Significant
CR	41.52%	25.76%	0.254	Not Significant
TDTER	190.78%	200.70%	0.845	Not Significant
AUR	8.00%	6.72%	0.431	Not Significant
IER	91.50%	77.33%	0.085	Not Significant
OER	174.12%	241.57%	0.015	Significant

Source: (Own Computation, 2025)

The data in Table 5 shows that while there were some differences in the financial ratios between Conventional and IFB banks from 2021 to 2023, the majority of these differences were not significant. Specifically, ratios related to profitability, liquidity, risk management, leverage, and efficiency showed no significant difference between the two types of banks. However, significant differences were observed in the areas of ROE, LDR, CPIDR, and OER, suggesting that in certain financial aspects, IFB banks outperformed Conventional banks.

Overall, the findings indicate that while some variations were significant, the overall performance of the banks remained relatively similar across most key financial metrics during this period. These results align with findings from other studies, which suggest that although there may be some performance differences between Conventional and IFBs, the financial metrics, particularly in areas like profitability and risk management, often exhibit limited

variation. Similar research by Abebe (2019), also found that despite differences in operational models, both banking types tend to perform similarly in core financial areas when controlled for market and economic conditions.

The lack of significant differences between Conventional and IFB banks in most financial ratios implies that the operational models of these two banking types may not necessarily translate into vastly different financial outcomes. This could suggest that both banking models are similarly effective in managing profitability, liquidity, and efficiency, possibly due to shared regulatory environments and market conditions. However, the significant differences inLDR, CPIDR, and OER indicate that there may be key areas where Conventional banks have advantages,on the other hand IFB have advantages on ROE.

4.7.3. Mann-Whitney U Test

Table 11 Mann-Whitney U Test p-value

Financial Ratio	Conventional Banks (Average 2021-2023)	IFB (Average 2021-2023)	Mann-Whitney U Test p-value	Conclusion
ROA	6.12%	6.70%	0.438	No Sig. Diff.
ROE	19.84%	34.35%	0.312	No Sig. Diff.
PER	82.14%	77.02%	0.498	No Sig. Diff.
ROD	31.13%	25.40%	0.134	No Sig. Diff.
LDR	80.87%	135.44%	0.445	No Sig. Diff.
LAR	38.01%	40.35%	0.824	No Sig. Diff.
CPIDR	279.30%	89.18%	0.297	No Sig. Diff.
DER	238.67%	333.38%	0.689	No Sig. Diff.
DTAR	58.48%	74.24%	0.965	No Sig. Diff.
EM	338.67%	433.38%	0.802	No Sig. Diff.
CR	41.52%	25.76%	0.835	No Sig. Diff.
TDTER	190.78%	200.70%	0.211	No Sig. Diff.
AUR	8.00%	6.72%	0.789	No Sig. Diff.
IER	91.50%	77.33%	0.461	No Sig. Diff.
OER	174.12%	241.57%	0.178	No Sig. Diff.

Source: (Own Computation, 2025)

The results presented in Table 6 show that there were no significant differences in the financial ratios between Conventional Banks and IFBs from 2021 to 2023. Specifically, the ratios for profitability, liquidity, risk management, leverage, and efficiency were largely similar for both groups of banks. This suggests that, despite the differences in their operational models, the overall financial performance of Conventional Banks and IFBs during the study period was comparable.

One key reason for this similarity could be the fact that both types of banks offer similar core banking services, such as savings accounts, loans, and deposits. While the method of generating profits differs Conventional Banks typically use interest-based systems, whereas IFBs rely on profit-sharing models the nature of the banking products themselves is quite similar. As a result, the financial outcomes and operational efficiencies for both types of banks appear to align closely.

Though it requires taking extra operational years to validate the outcome, this finding challenges the assumption that the fundamental differences in banking principles (i.e., interest-bearing vs. interest-free operations) lead to significantly different financial outcomes.

CHAPTER FIVE
SUMMARY OF RESULTS, CONCLUSION AND RECOMMENDATIONS

5.1. Summary of Results

The comparative analysis of the financial performance between Conventional and Interest-Free Banks (IFBs) in Ethiopia for the years 2021 to 2023 revealed valuable insights into their operational dynamics. Financial ratios were evaluated across five categories: Profitability, Liquidity, Risk and Solvency, Leverage, and Efficiency. Using both the t-Test and Mann-Whitney U Test, it was observed that the majority of the differences in financial ratios between the two banking models were not statistically significant. However, notable significant differences were identified in ROE, LDR, CPIDR, and OER.

In terms of profitability, the Return on Assets (ROA) was slightly higher for IFBs 6.70% compared to Conventional Banks 6.12%, but this difference was not statistically significant. The Return on Equity (ROE) for IFBs (34.35%) significantly exceeded that of Conventional Banks (19.84%, $p = 0.022$), reflecting IFBs' ability to generate superior returns on shareholder equity. While the Profit Expense Ratio (PER) and Return on Deposits (ROD) were not significantly different, the higher ROE highlights a key area of IFBs' financial strength.

In the liquidity category, the Loan-to-Deposit Ratio (LDR) was significantly higher for IFBs (135.44%) compared to Conventional Banks (80.87%, $p = 0.042$). This suggests a more aggressive lending approach by IFBs. The Cash and Marketable Securities-to-Deposit Ratio (CPIDR) was significantly lower for IFBs (89.18%) compared to Conventional Banks (279.30%, $p = 0.001$), indicating a difference in liquidity management strategies.

In the area of risk and solvency, the Debt-to-Equity Ratio (DER), Debt-to-Total Assets Ratio (DTAR), and Equity Multiplier (EM) were all higher for IFBs compared to Conventional Banks, reflecting greater reliance on leverage. However, these differences were not statistically significant.

For leverage ratios, Conventional Banks exhibited stronger Capital Ratios (CR) at 41.52%, compared to 25.76% for IFBs, but this difference was not significant. Both banking models relied heavily on deposits for funding, as reflected in their Total Deposits-to-Equity Ratios (TDTER), though the differences were not statistically significant.

Lastly, regarding efficiency, the Operating Expense Ratio (OER) was significantly higher for IFBs (241.57%) compared to Conventional Banks (174.12%, $p = 0.015$), suggesting relatively higher operational costs for IFBs. Other efficiency metrics, such as the Asset Utilization Ratio (AUR) and Income-to-Operating Expense Ratio (IER), did not demonstrate significant differences.

5.2. Conclusion

The findings of this study highlight that while Conventional Banks and Interest-Free Banks (IFBs) in Ethiopia operate with differing strategies; their overall financial performance remains statistically comparable for most metrics. Conventional Banks demonstrated stronger liquidity buffers and lower operating expenses, reflecting robust stability and cost efficiency. They also maintained a more conservative approach to lending.

On the other hand, IFBs exhibited significantly higher ROE, reflecting their superior ability to generate returns for shareholders. Their aggressive lending approach, as indicated by the significantly higher LDR, and their lower liquidity reserves (CPIDR) suggest a growth-focused strategy, albeit with potentially increased financial risks. The significantly higher OER for IFBs highlights the need to address operational inefficiencies.

The lack of statistically significant differences in most metrics underscores that both banking models are viable within the Ethiopian financial landscape. Conventional Banks provide stability and resilience, while IFBs excel in profitability and growth potential. The choice between these models depends on stakeholder priorities and market demands.

5.3. Recommendations

Based on the findings from this study, the following recommendations are proposed:

For Conventional Banks:

- Strengthen liquidity management practices to ensure competitiveness in an evolving financial landscape.
- Leverage their stability to explore innovative products that attract a broader customer base.

For Interest-Free Banks (IFBs):

- Enhance capital adequacy by increasing equity levels, reducing dependency on debt financing and mitigating leverage-associated risks.
- Optimize operational expenses through cost-control measures, such as process automation and resource allocation strategies, without compromising service quality.
- Reevaluate their liquidity management strategies to maintain adequate reserves while pursuing growth-oriented lending practices.

5.4. Recommendations for Future Studies

Future research could:

1. Conduct longitudinal studies on the financial performance of Conventional and IFBs across economic cycles to assess their adaptability and resilience.
2. Analyze the impact of regulatory frameworks, including capital adequacy and liquidity requirements, on the financial performance of both banking models.
3. Investigate the role of Conventional and IFBs in promoting financial inclusion, particularly in underserved regions, to understand their contributions to broader economic development.
4. Explore comparative insights from countries with well-established IFB systems to identify best practices and potential applications to Ethiopia's banking sector.

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APPENDICES

Appendix 01 Financial Statement of Tsedey Bank

Table 12 Financial Statement of Tsedey Bank

INCOME STATEMENT				
	30-Jun-23	**30-Jun-22**	**30-Jun-21**	**30-Jun-20**
Interest income	6,202,442,039	4,734,771,703	4,350,272,623	3,998,402,543
Interest expense	1,911,778,369	1,713,427,495	1,369,779,164	1,266,479,916
Net interest income before impairment	**4,290,663,670**	**3,021,344,208**	**2,980,493,459**	**2,731,922,627**
Less: loan impairment recovery/(charges)	590,180,294	131,125,807	384,673,946	541,177,521
Net interest income	**4,880,843,964**	**2,890,218,401**	**2,595,819,513**	**2,190,745,106**
Fees and commission income	107,340,879	109,318,766	160,911,867	118,767,506
Net fees and commission income	**107,340,879**	**109,318,766**	**160,911,867**	**118,767,506**
Other operating income	245,183,113	192,027,752	169,523,727	202,074,535
Net operating income	**5,233,367,956**	**3,191,564,919**	**2,926,255,107**	**2,511,587,147**
Total Revenue	**6,554,966,031**	**5,036,118,221**	**4,680,708,217**	**4,319,244,584**
Expenses				
Salaries and other employee benefits	3,273,412,877	1,560,367,751	1,356,754,526	1,193,559,971
General and administrative	681,651,570	163,758,427	146,749,458	126,856,705
Depreciation on property, plant and equipment	35,832,111	26,039,929	36,481,802	23,981,301
Amortization of intangible asset	103,839,527	3,884,200	7,222,095	3,521,402
Impairment on other assets	21,048,121	29,300,300	7,703,063	-
Total operating expenses	**4,115,784,206**	**1,783,350,607**	**1,554,910,944**	**1,347,919,379**
Net profit before business income tax	**1,159,679,992**	**1,408,214,312**	**1,371,344,113**	**1,163,667,768**
Business income tax expenses	**(105,053,388)**	-		
Total expenses	**6,027,562,575**	**3,496,778,102**	**2,924,690,108**	**2,614,399,295**
Profit for the year after business income tax	**1,054,626,604**	**1,408,214,312**	**1,371,344,113**	**1,163,667,768**
Other comprehensive income				
Change in equity investment at FVOCI	(22,951,539)	346,345,382	23,703,827	10,627,791
Total comprehensive income for the year	**1,031,675,065**	**1,754,559,694**	**1,395,047,940**	**1,174,295,559**
BALANCE SHEET				
ASSETS	**30-Jun-23**	**30-Jun-22**	**30-Jun-21**	**30-Jun-20**
Cash and cash equivalents	12,649,968,117	13,461,778,795	11,605,530,844	7,955,192,143
Other assets and pre-payments	2,505,486,828	1,785,151,470	1,563,237,301	1,300,104,334
Loans and advances to customers	36,490,603,190	25,697,057,588	22,899,243,830	22,219,065,099

Property, plant and equipment	2,862,448,820	2,079,204,697	1,814,832,676	1,267,016,992
Intangible assets	505,169	678,302	1,095,594	1,687,121
Right of use asset	454,799,473	61,102,721	27,603,287	22,481,042
Financial assets at amortized cost	243,674,000	30,000,000	30,000,000	25,000,000
Financial assets at fair value through OCI	1,353,607,595	1,344,829,536	934,819,154	746,971,876
Deferred tax assets	84,609,393			
TOTAL ASSETS	**56,645,702,585**	**44,459,803,109**	**38,876,362,686**	**33,537,518,607**
LIABILITIES				
Deposit from customers	34,169,831,843	24,581,383,795	21,764,502,730	18,207,770,657
Borrowing	783,075,790	1,052,514,584	1,332,235,991	1,353,655,033
Employee benefits obligations	330,102,147	154,100,018	128,648,363	132,097,068
Lease obligations	147,421,372	11,738,724	20,554,692	15,350,707
Other liabilities	8,662,114,829	7,351,157,496	6,135,586,412	5,711,963,605
Deferred tax liabilities	233,301,033	-		
TOTAL LIABILITIES	**44,325,847,014**	**33,150,894,617**	**29,381,528,188**	**25,420,837,070**
EQUITY				
Share capital	9,828,048,000	7,749,050,000	7,749,050,000	1,000,000,000
Donated equity	191,964,104	190,663,077	190,663,077	190,663,077
Legal reserve	947,620,936	871,853,844	519,800,266	176,964,238
Capital reserve	5,298,177	-		
General reserve	4,222	4,222	4,222	-
Reserve for change in equity investment	388,289,608	411,241,147		
Retained earnings	958,630,524	2,086,096,202	1,035,316,930	6,749,054,222
TOTAL EQUITY	**12,319,855,571**	**11,308,908,492**	**9,494,834,495**	**8,116,681,537**
TOTAL LIABILITIES AND EQUITY	**56,645,702,585**	**44,459,803,109**	**38,876,362,683**	**33,537,518,607**
TOTAL DEBT	**44,325,847,014**	**33,150,894,617**	**29,381,528,191**	**25,420,837,070**

Appendix 02 Financial Statement of Tsehay Bank

Table 13 Financial Statement of Tsehay Bank

INCOME STATEMENT		
	30-Jun-23	30-Jun-22
Interest Income	66,923,672	7,983,116
Interest Expense	35,775,141	
-Net Interest Income	**31,148,531**	**7,983,116**
Impairment losses on loans and Advances 12	11,102,421	-
Net Interest Income after Impairment losses	**20,046,110**	**7,983,116**
Non-Interest Income	25,211,735	56,786,970
Net operating income	**45,257,845**	**64,770,086**
Total Revenues	**92,135,407**	**64,770,086**
Expenses	531,677,162	77,157,424
Loss before tax	**(486,419,317)**	**(12,387,338)**
Total expenses	**567,452,303**	**77,157,424**
Income Tax Recoverable	152,801,060	6,010,896
Loss after tax	**(333,618,257.00)**	**(6,376,441.00)**
Other Comprehensive Income		
Items that will never be reclassified Subsequently to profit or loss:		
Re-measurement gain (loss) on employee benefit obligation	(3,879,000.00)	-
Gain (Loss) arising from measurement equity instrument at fair value	247,905,780.00	-
Related tax	(73,208,034.00)	-
Other Comprehensive Income, net of tax	**170,818,746.00**	**-**
Total Comprehensive Income for the year	**(162,799,511.00)**	**(6,376,441.00)**
ASSETS	**30-Jun-23**	**30-Jun-22**
Cash and Cash Equivalent	789,557,561	495,060,441
Debt & Equity securities	556,390,158	
Loans, Advances, and IFB Financing to Customers, net	1,056,988,049	
Property, Plant and Equipment, net	356,759,144	113,802,676
Intangible Asset,	-	-
Right of Use Assets, net	371,908,688	101,771,788
Other Assets	392,296,299	93,059,501
Deferred Tax Asset	-	6,538,786
Total Assets	**3,523,899,900**	**810,233,193**

Equity and Liabilities		
Liabilities		
Deposits Due to Other Banks	100,105,290	
Customers' Deposits	2,202,440,151	
Finance Lease Obligations	152,116,195	73,734,459
Employee Benefits	4,343,000	
Other Liabilities	60,258,634	8,906,175
Deferred Tax Liabilities	72,638,180	
Total Liabilities	**2,591,901,450**	**82,640,634**
Equity		
Share Capital	1,087,773,650	733,969,000
Retained Earning	(339,994,700.00)	(6,376,441.00)
Regulatory Impairment Reserve	13,400,754	
Other Reserve	170,818,746	
Total Capital (Equity)	**931,998,450**	**727,592,559**
Total Liability and Equity	**3,523,899,900**	**810,233,193**
TOTAL DEBT	**2,591,901,450**	**82,640,634**

Appendix 03 Financial Statement of Amhara Bank

Table 14 Financial Statement of Amhara Bank

INCOME STATEMENT		
	30-Jun-23	**30-Jun-22**
Notes		
Interest income	1,591,593.00	182,143.00
Interest expense	(432,104.00)	(2,058.00)
Net interest income	**1,159,488.00**	**180,086.00**
Fee and commission income	155,585.00	325,816.00
Fee and commission expense	-	-
Net fees and commission income	**155,585.00**	**325,816.00**
Other operating income	29,528.00	23,043.00
Total operating income	1,344,601.00	528,945.00
Loan impairment charge	53,132.00	-
Impairment losses	1,158.00	-

Net operating income	**1,398,891.00**	**528,945.00**
Total Revenues	**1,776,706**	**531,002**
Personnel expenses	1,090,920.00	96,214.00
Amortisation of intangible assets	23,940.00	3,686.00
Depreciation and impairment of property, plant and equipment	108,288.00	12,735.00
Other operating expenses	548,918.00	179,346.00
Total Operating expenses	**1,772,066**	**291,981**
Total Expenses	**1,394,252**	**289,923**
Profit before tax	**4,947,663.00**	**1,351,928.00**
Income tax (expense) income 12,a	311,697.00	(39,853.00)
Profit after tax	**5,259,360.00**	**1,312,075.00**
Other comprehensive income (OCI) net on income tax		
Items that will not be subsequently reclassified into profit or loss:		
Re-measurement gain/loss on retirement benefits obligations	(15,396.00)	-
Deferred tax liability/asset on re-measurement gain or loss	4,619.00	-
Re-measurement gain / loss on fair value of Equity investment	50,321.00	-
Deferred tax liability/asset on fair value of Equity investment	(15,096.00)	-
	24,447.00	
Total comprehensive income for the period	**5,283,807.00**	**1,312,075.00**
ASSETS	**30-Jun-23**	**30-Jun-22**
Cash and balances with banks	7,306,118.00	5,919,179.00
Loans and advances to customers	14,938,827.00	-
Investment securities:		
-Equity Share Investment	60,656.00	10,222.00
-Amortized cost	1,586,510.00	-
Other assets	1,273,930.00	87,750.00
Deferred asset	279,844.00	
Intangible assets	123,120.00	58,963.00
Property, plant and equipment	1,164,712.00	477,484.00
Right of Use Asset	1,699,396.00	519,642.00
Total assets	**28,433,113.00**	**7,073,240.00**
LIABILITIES		
Deposits from customers	19,820,243.00	401,097.00
Current tax liabilities	-	18,478.00

Borrowings 21 -	-	-
Other liabilities	2,226,355.00	1,361,478.00
Lease liabilities	488,632.00	242,058.00
Retirement benefit obligations	18,937.00	-
Deferred tax liabilities	-	21,375.00
Total liabilities	**22,554,167.00**	**2,044,486.00**
EQUITY		
Share capital	5,842,230.00	4,831,642.00
Retained earnings	(130,293.00)	147,833.00
Legal reserve	49,278.00	49,278.00
Regulatory risk reserve	93,285.00	-
Other reserves	24,447.00	-
Total equity	**5,878,948.00**	**5,028,753.00**
Total equity and liabilities	**28,433,113.00**	**7,073,240.00**
TOTAL DEBT	**22,554,165**	**2,044,487**

Appendix 04 Financial Statement of AhaduBank

Table 15 Financial Statement of Ahadu Bank

INCOME STATEMENT		
	30-Jun-23	**30-Jun-22**
Interest income	29,931	21,701
Interest expense	21,539.00	-
Net interest income	**8,392**	**21,701**
Fee and commission income	96,129	12
Fee and commission expense	3,422.00	726.00
Net Fee and commission income	**92,707.00**	**(714.00)**
Net gain on foreign exchange valuation	19,548	3,542
Other operating income	927	43
	20,475	**3,585**
Total operating income	**121,574.00**	**24,572.00**
Loan impairment Charge	121.00	-
Other assets impairments charge	66.00	-
	187.00	

Net operating income	**121,761.00**	**24,572.00**
Total Revenues	**146,535.00**	**25,298.00**
Personnel expenses	193,470.00	15,229.00
Depreciation & Amortization intangible assets	25,786.00	3,046.00
Depreciation of Right use of assets	64,976.00	14,918.00
Other operating expenses	104,746.00	11,038.00
Total Operating Expense	**388,978.00**	**44,231.00**
Total Expense	**414,126.00**	**44,957.00**
Profit before tax	**510,739.00**	**68,803.00**
Income Tax expense	73,915.00	-
Profit after tax	**(193,675.00)**	**(19,658.00)**
Other comprehensive income (OCI)		
Items that will not be subsequently reclassified into profit or loss:		
Re-measurement gain/(loss) on Retirement benefits obligations	(2,635.00)	-
Deferred tax assets/(liabilities) on re-measurement gain or loss	644.00	8,394.00
Net change in Retirement benefits obligations at FVOCI	**(1,991.00)**	**8,394.00**
Fair value through OCI on Financial assets - Unrealized gain/(Loss) arising from Equity Investments	14,998.00	-
Deferred tax assets/(liabilities) on re-measurement equity Investments	(4,499.00)	-
Net change in re-measurement equity Investments at FVOCI	**10,499.00**	**-**
Total comprehensive income for the period	**(185,168.00)**	**(11,264.00)**
Basic earnings(Loss) per share(500 Birr)	(166.00)	-
BALANCE SHEET		
ASSETS	**30-Jun-23**	**30-Jun-22**
Cash and bank balances	1,015,918	386,279
Loans and advances to customers	924,654	0
Investments Securities :		
- Financial asset at Fair value through OCI	31,636	6,001
- Financial asset at Amortized cost	89,416	0
Other assets	185,208	8,577
Right of Use Asset	375,103	125,677
Property, plant and equipment	346,795	98,074
Intangible Assets-Software	41,582	0
Non-current asset held for sale	0	0

Deferred tax assets	0	8,394
Profit tax recoverable (Loss carrying forward)	86,171	0
Total assets	**3,096,483**	**633,002**
LIABILITIES		
Deposits from customers	2,026,855	0
Current tax liabilities 16 -	0	0
Other liabilities	389,913	58,786
Lease liabilities	183,821	65,820
Defined benefits obligation	2,906	0
Deferred tax liabilities	3,693	0
Total liabilities	**2,607,189**	**124,606**
EQUITY		
Share Capital	672,626.00	510,584.00
Retained Earnings(Loss)	(201,883.00)	(2,188.00)
OCI-Defined Employee Benefit	(1,991.00)	-
OCI-Equity Investment	10,499	-
Legal Reserve	-	-
Regulatory Risk Reserve	10,044	-
Total Equity	**489,294.00**	**508,396.00**
Total equity and liabilities	**3,096,483**	**633,002**
TOTAL DEBT	**2,607,189.00**	**124,606.00**

Appendix 05 Financial Statement of SiinqeBank

Table 16 Financial Statement of Siinqe Bank

INCOME STATEMENT			
	30-Jun-23	30-Jun-22	30-Jun-21
Interest income	3,209,753,185	2,388,440,800	1,944,229,743
Interest expense	810,841,428	462,046,375	416,061,099
Net interest income	**2,398,911,757**	**1,926,394,425**	**1,528,168,644**
Fees and commission income	171,338,271	58,108,041	48,389,743
Other operating income	299,893,372	329,366,560	320,817,044
less: Loan impairment charge	205,976,298	(659,887,674)	(272,457,769)
Net operating income	**2,664,167,101**	**1,653,981,352**	**1,624,917,662**
Total Revenues	**3,680,984,828**	**2,775,915,401**	**2,313,436,530**
Operating expense			
Salaries and other employee benefits	1,581,496,081	1,007,446,052	777,726,340
General and administrative expenses	538,049,982	222,300,686	233,257,063
Depreciation on property, plant and equipment	48,763,652	27,079,988	14,794,409
Depreciation charge - lease	88,450,766	21,172,948	36,114,651
Depreciation charge - land lease	174,803	-	
Amortization of Intangible asset	33,761,726	4,420,868	1,881,084
Impairment loss of - other asset	8,001,950	-	428,117
TOTAL Operation expense	**2,298,698,961**	**1,282,420,542**	**1,064,201,664**
TOTAL expense	**3,315,516,687**	**1,084,579,243**	**1,207,804,994**
Profit before tax	365,468,141	371,560,810	560,715,998
Income tax expense	(80,669,367)	8,645,216	
Profit for the year after tax	284,798,774	380,206,026	560,715,998
Other comprehensive income (OCI) Net of income tax			
Item that will not be subsequently reclassified in to profit			
or Loss			
Re-measurement gain/Loss on retirement benefit obligation	(42,198,414)	(1,773,409)	
Deferred tax liability/asset on re-measurement gain or loss			
on Equity investment			
Deferred tax liability/asset on re-measurement gain or loss	140,661,381	5,911,364	(204,186)
on defined benefit obligation			

Revaluation gain equity investment net effect of gain/loss			
Total comprehensive income for the year	**383,261,741**	**384,343,981**	**560,511,812**
BALANCE SHEET			
ASSETS	**30-Jun-23**	**30-Jun-22**	**30-Jun-21**
Cash and Cash Equivalent	7,180,943,553	2,955,856,730	2,445,856,097
Other Assets and prepayment	2,292,076,094	435,761,768	149,867,361
Loans and Advances Customers, net	23,021,157,253	16,264,606,254	12,853,100,548
Property, Plant and Equipment, net	812,926,894	386,414,695	229,864,863
Intangible assets	245,117,452	85,276,946	11,468,287
Right of Use Assets, net	642,027,279	142,800,438	114,449,510
Lease hold land	8,654,587	9,860,811	
Inventory in securities	410,707,931	244,120,467	218,985,986
Acquired property	6,299,084	4,464,328	
Deferred Tax Asset	51,187,307	30,955,291	
Total Assets	**34,671,097,435**	**20,560,117,727**	**16,023,592,652**
Equity and Liabilities			
Liabilities			
Customers' Deposits	23,725,034,017	10,278,175,832	6,098,193,709
Borrowing	862,450,899	948,391,037	865,352,942
Lease liabilities	143,837,218	18,984,851	
Land Lease liabilities	3,981,348	4,103,822	43,910,886
Other Liabilities	1,267,755,414	1,167,188,328	1,290,347,196
Retirement benefit obligations	23,365,812	19,923,205	9,883,007
Provision for profit tax	40,916,219		
Deferred Tax Liabilities	124,264,906	22,310,074	
Total Liabilities	**26,191,605,833**	**12,459,077,149**	**8,307,687,741**
Equity	7,777,406,433	7,445,355,513	7,004,583,843
Share Capital	114,199,172	114,199,172	118,348,415
Donated equity	230,709,584	159,509,891	120,000,000
Legal reserve	231,830,613	355,093,170	440,771,670
Retained Earning	125,345,798	26,882,831	32,200,986
Other Reserve			
Total Capital (Equity)	**8,479,491,601**	**8,101,040,577**	**7,715,904,914**
Total Liability and Equity	**34,671,097,434**	**20,560,117,727**	**16,023,592,655**

TOTAL DEBT	**26,191,605,834**	**12,459,077,150**	**8,307,687,738**

Appendix 06 Financial Statement of ZamzamBank

Table 17 Financial Statement of Zamzam Bank

INCOME STATEMENT			
INCOME	**30-Jun-23**	**30-Jun-22**	**30-Jun-21**
Profit income	337,574,108	6,850,446	
Profit Sharing expense to Mudarabah depositor's	8,066,225	338,268	
Net profit income	**329,507,883**	**6,512,178**	
Other operating income	187,305,589	34,069,605	19,500
Total operating income	**516,813,472**	**40,581,783**	**19,500**
Total Revenues	**524,879,697**	**40,920,051**	**19,500**
EXPENSES			
Salaries and benefits	295,957,232	94,448,343	13,763,683
Depreciation	31,245,919	9,491,916	19,168
Other operating expenses	164,403,551	80,221,392	6,447,152
Audit fees	402,500	188,185	304,750
Director's related expenses	661,333	2,640,000	-
Total Operating expense	**492,670,536**	**186,989,836**	**20,534,753**
Total expense	**500,736,761**	**187,328,104**	**20,534,753**
Profit(loss) before tax	24,142,936	(146,408,053)	20,515,253
Income tax expense	-	-	-
Profit (loss) after tax	**24,142,936**	**(146,408,053)**	**(20,515,253)**
Other comprehensive income (OCI) net of income tax			
Re-measurement loss on retirement benefits	(3,313,000)	-	-
Fair value gain of Equity Investments	19,904,510	38,535,555	
Total other comprehensive income	**16,591,510**	**38,535,555**	
Total comprehensive income for the period	**40,734,446**	**(107,872,498)**	
BALANCE SHEET			
	30-Jun-23	**30-Jun-22**	**30-Jun-21**
ASSETS			
Cash and bank balances	1,534,679,037	1,426,990,918	829,750,293
Financing and investment to customers	3,584,764,933	689,105,913	
Accrued profit receivable on Murabaha	759,814,450	150,601,161	
Investment securities:		-	-

Equity investment at FVOCI	70,442,065	50,537,555	
Investment Government Bond	6,890,000		
Other assets	224,141,110	62,014,466	43,782,379
Mudarabah investment	580,000,000	350,000,000	
Property, plant and equipment	258,478,175	208,383,024	11,792,734
Right of use lease hold land	161,593,925		
Intangible assets	56,235,994	42,332,167	
Right of use asset	256,706,923	176,923,325	
Deferred tax asset	-	-	-
Total Assets	**7,493,746,611**	**3,156,888,528**	**885,325,406**
LIABILITIES			
Deposit from customers	4,980,509,321	1,586,167,125	7,543,643
Other liabilities	195,770,697	207,047,588	26,432,016
Leasehold land liability	137,354,836	-	
Unearned profit UID for Murabaha	569,528,462	144,796,966	-
Total Liabilities	**5,883,163,317**	**1,938,011,679**	**33,975,660**
EQUITY			
Paid up capital	1,699,137,908	1,341,650,199	871,865,000
Other reserve	55,127,065	38,535,555	
Legal Reserve	6,035,734		
Retained earnings	(155,331,814)	(166,923,306)	(20,515,253)
Regulatory risk reserve	5,614,401	5,614,401	-
Total equity	**1,610,583,294**	**1,218,876,849**	**851,349,747**
Total Equity and Liabilities	**7,493,746,611**	**3,156,888,528**	**885,325,406**
TOTAL DEBT	**5,883,163,317**	**1,938,011,679**	**33,975,659**

Appendix 07 Financial Statement of ShebeleBank

Table 18 Financial Statement of Shebele Bank

INCOME STATEMENT		
	30-Jun-23	**30-Jun-22**
Mark-up income	192,911,581.00	52,838,101.00
Mark-up expense	-	-
Net income	**192,911,581.00**	**52,838,101.00**
Fee and commission income	272,949,954.00	249,555,139.00
Other operating income	51,316,948.00	18,513,493.00
	324,266,902.00	**268,068,632.00**
Total operating income	**517,178,483.00**	**320,906,734.00**
Total revenues	**517,178,483.00**	**320,906,733.00**
Loan impairment Charge	14,622,818.00	3,532,509.00
Personnel expenses	187,417,515.00	124,946,220.00
Fee and commission expense	91,239,225.00	76,343,663.00
Depreciation expense of property, plant& equipment	17,150,564.00	4,525,039.00
Other operating expenses	173,561,263.00	89,856,920.00
Total operating expenses	**483,991,386.00**	**299,204,351.00**
Total expenses	**483,991,386.00**	**299,204,351.00**
Profit before tax	33,187,097.00	21,702,382.00
Income Tax expense on PL	13,348,791.00	446,298.00
Profit after tax	**19,838,306.00**	**21,256,084.00**
Other comprehensive income	8,927,044.00	2,429,846.00
Income Tax expense on OCI	(2,678,113.00)	(728,954.00)
Other comprehensive income (OCI) net	**6,248,931.00**	**1,700,892.00**
Total comprehensive income for the period	**26,087,236.00**	**22,956,977.00**
BALANCE SHEET		
ASSETS	**30-Jun-23**	**30-Jun-22**
Cash and balances with banks	853,499,189.00	725,819,584.00
Loans and advances to customers	1,877,176,988.00	1,888,811,625.00
Investment securities:		
- Financial asset measured at FVPL	83,749,814.00	11,967,846.00
Other receivable	494,372,461.00	211,398,435.00
Inventory	23,939,769.00	19,581,688.00

Property, plant and equipment	407,520,195.00	297,945,178.00
Intangible assets	20,134,868.00	3,609,329.00
Total assets	**3,760,393,285.00**	**3,159,133,684.00**
LIABILITIES		
Deposits from customers	801,613,728.00	500,535,068.00
Other payable	2,270,400,289.00	2,070,792,576.00
Current tax payable	16,434,147.00	2,086,466.00
Deferred tax liabilities	768,010.00	(911,214.00)
Retirement benefit obligations	1,830,052.00	672,068.00
Total liabilities	**3,091,046,226.00**	**2,573,174,964.00**
EQUITY		
Paid up capital	594,930,000.00	515,940,000.00
Donated EQUITY	3,918,681.00	3,918,681.00
Legal reserve	14,754,681.00	10,000,000.00
Retained earnings	29,807,697.00	30,164,040.00
Revaluation Reserve	25,936,000.00	25,936,000.00
Total equity	**669,347,059.00**	**585,958,720.00**
Total equity and liabilities	**3,760,393,285.00**	**3,159,133,684.00**
TOTAL DEBT	**3,091,046,226.00**	**2,573,174,964.00**

Appendix 08 Financial Statement of HijraBank

Table 19 Financial Statement of Hijra Bank

INCOME STATEMENT		
	30-Jun-23	**30-Jun-22**
Income from financing and Investment	336,684,389.00	19,103,421.00
Income paid to depositor	-	-
Net income from financing and Investment	**336,684,389.00**	19,103,421.00
Fee and commission Income	68,438,132.00	7,746,287.00
Fee and commission expense	1,549,435.00	309,448.00
Net Fee and commission Income	**66,888,698.00**	**8,055,735.00**
Net foreign exchange valuation gain/loss	5,897,254.00	23,814.00
Other operating income	13,562,634.00	1,011,188.00
	19,459,888.00	**1,035,001.00**
Total operating income	**423,032,974.00**	**28,194,157.00**
Total Revenues	**424,582,409.00**	**27,884,710.00**
impairment on Loan and advance	10,640,897.00	3,745,897.00
impairment on other assets	546,337.00	606,684.00
	11,187,234.00	**4,352,581.00**
Net operating income	**411,845,741.00**	**23,222,681.00**
Personnel expenses	222,446,767.00	97,370,966.00
Promotion expenses	7,221,645.00	6,657,361.00
Depreciation and amortization	78,295,653.00	32,159,816.00
Genaral and administrative expenses	76,085,653.00	30,078,295.00
Total operating expenses	**384,049,718.00**	**166,266,438.00**
Total expenses	**396,786,387.00**	**170,928,467.00**
Profit before tax	**27,796,023.00**	**(143,043,758.00)**
Other comprehensive income		
Items that will not be subsequently reclassified into profit or loss:		
Financial asset at FVOCI(equity investment)	16,694,487.00	-
Deferred tax liability/asset on re-measurement gain or loss	(4,501,582.00)	(32,767.00)
	12,192,905.00	
Total comprehensive income for the period	**39,988,928.00**	**(143,043,758.00)**
BALANCE SHEET		
ASSETS	**30-Jun-23**	**30-Jun-22**

Cash and balances with banks	2,395,626,930.00	978,612,178.00
Other Non-financial asset	71,047,463.00	24,115,212.00
Other financial asset	61,603,024.00	158,316,477.00
Murabaha financing	3,000,556,604.00	316,069,817.00
Short term Investment		440,000,000.00
Equity Investment	25,258,960.00	3,000,500.00
Intangible assets -software	40,811,380.00	18,363,693.00
Right of Use Asset	198,177,595.00	609,728.00
Property, plant and equipment	390,731,672.00	283,961,681.00
Total assets	**6,183,813,627.00**	**2,223,049,286.00**
LIABILITIES		
Deposits from customers	4,840,500,215.00	1,334,303,666.00
Other financial liabilities	94,799,970.00	19,100,114.00
Non-financial liabilities	21,223,764.00	6,548,094.00
Deferred tax liabilities	5,074,565.00	572,983.00
Lease liabilities	26,809,310.00	
Total liabilities	**4,988,407,825.00**	**1,360,524,857.00**
EQUITY		
Share capital	1,274,806,000.00	979,934,000.00
Retained earnings	(123,812,211.00)	(117,409,570.00)
OCI-equity investment	16,694,487.00	
Legal reserve	6,949,006.00	
Regulatory risk Reserve	20,768,521.00	
Total equity	**1,195,405,803.00**	**862,524,430.00**
Total equity and liabilities	**6,183,813,628.00**	**2,223,049,287.00**
TOTAL DEBT	**4,988,407,824.00**	**1,360,524,856.00**