



**ASSESSMENT OF PROSPECTS AND CHALLENGES OF INTEREST FREE BANKING
IN ETHIOPIA IN THE CASE OF COMMERCIAL BANK OF ETHIOPIA, NORTH
ADDIS DISTRICT**

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**A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY, SCHOOL OF GRADUATE
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This is to certify that Yewubdar Getachew has worked this thesis on the topic —challenges and prospect of IFB under my supervision. To my belief, this work undertaken by Yewubdar Getachew and it is original and qualifies for submission in partial fulfillment of the requirements for the award of MBA in general management.

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ACRONYMS

NBE	NATIONAL BANK OF ETHIOPIA
CBE	COMMERCIAL BANK OF ETHIOPIA
IS	ISLAMIC BANKING
IFB	INTEREST FREE BANKING
UB	UNITED BANK
BOA	BANK OF ABYSSINIYA
COB	COOPERATIVE BANK OF OROMIA
NIB	INTERNATIONAL BANK,
AB	ABAY BANK
WB	WEGAGEN BANK
IFBW	INTEREST FREE BANKING WINDOW

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ABSTRACT

This study examines challenges and prospect of Interest free banking services in Ethiopia with particular reference to the commercial bank of Ethiopia North Addis District. The study has employed descriptive research based on survey and the data are of cross sectional type. The study has used both primary and secondary data which are quantitative and qualitative in nature and have been collected through structured and semi structured questionnaire and interview. A total of 435 sample respondents were taken through multistage sampling. Of the total sample interest free banking customers and staffs of the bank constitutes 367 and 68 respectively. The data was analyzed using descriptive statistics of mean, frequency and percentage using SPSS version 20 software. Based on the analysis of the obtained data, this research has found out the prospect of IFB are the existence of Potential customer and the diplomatic advantages. In Ethiopian there is potential customer and Ethiopian Investment framework is favorable also for investors, so these create favorable condition for the development of IFB. On the other side, the challenges to deliver IFB services as: lack of Shariah advisor, lack of supportive regulatory directives, lack of awareness of customer about IFB products and absence of equity markets. On the other hand, unavailability of IFB service in all branches, unequal treatment of debt and equity and double taxation and lack of trust within the bank are the main challenges customer face to utilize the products. Accordingly, the following recommendations were forwarded by the researcher based on the results of the findings in conjunction with literature review reflections: aggressive promotion and marketing campaign about IFB products, provide sustainable and continuous training to build the capacity of the manpower, the bank shall increase accessibility of its products within all branches, the bank has to have Shariah advisor, the bank should give the required attention and focus for the business and the bank has to be transparent in its IFB business undertaking, in addition government should prepare compatible regulatory framework.

Key words: *Interest Free Banking, Interest Free banking window service, Islamic Finance*

CHAPTER ONE

1. Introduction

1.1 Background of the study

The interest-free banking system is one which operates according to the tenets/teachings of the Islamic faith. The most important feature of this banking system is that it is interest-free. Apart from this feature, the interest-free banking system has other objectives – amongst which are the equitable distribution of income and wealth and increased equity participation in the economy (Clifford, 2008). It also prohibited investing in businesses that provide goods or services considered contrary to its principles, *Haraam*, such as businesses that sell alcohol or pork, or businesses that produce media such as gossip columns or pornography, which are contrary to Islamic values (Mohammed 2012).

According to the 2007 national census, the Muslim population comprises 33.9% of the total population (www.csa.gov.et accessed on 12/02/2016) in Ethiopia; this offers the opportunity for substantial customers that would patronize Islamic banking products. The national census shows in Ethiopia there is a huge potential for Islamic/interest free banking service. The study made by Mohammed (2012), has found out that there is need for Islamic banking products and services in Ethiopia. Beyond satisfying the need of Ethiopian customers Islamic banking will also create for Ethiopian government to gain diplomatic advantages to make financial dealings with Muslim dominated nations (Usmani, 2002).

Islamic banking, on the one side, is being spread all over the world and regarded as a fastest growing market, on the other side; it is not free from issues, problems, and challenges. The Islamic banking faces serious problems to practice Islamic laws, proper interbank money market is not available and poor regulatory framework for interest free banking (Irfan, Majeed & Zaman 2014).

To satisfy the demand of Ethiopian Muslim customers, National Bank of Ethiopia (NBE) in 2008 amended Ethiopian Banking Business Proclamation (592/2008) to include provision of IFB and it paved the way for the establishment of Islamic banking in Ethiopia. However, the declaration was amended by another declaration (SSB/51/2011) which prohibited the establishment of full-

fledged Islamic financial institution but give the right to open the door for existing commercial banks to create an interest-free banking wing. As (Senait,2015) explanation Zemzem bank which was expected to join the banking industry as a full-fledged interest free banking, was unable to start operation as the supervisory directive requires that interest-free banking be given alongside conventional banking service.

After the issuance of working directive, SBB/51/2011, different commercial banks granted the license to deliver interest free banking service to their end customers. OIB is the first bank which granted the license in September 16, 2013 by following CBE in September 17, 2013. UB also start to provide interest free banking service after granted the license in May 1, 2014 and recently, BOA, CBO, NIB, AB and WB have joined the IFB business by giving depository products for the time being. However, the purpose of this study is assess the challenges that Banks face in implementing interest free banking service and identify the prospect of interest free banking in the case of CBE North Addis District.

1.2 Statement of the problem

Just 40 years since its contemporary inception, Islamic banking is now a worldwide phenomenon, with Islamic banks in over 60 countries across the Globe (Akhtar 2007). The development of the Islamic banking industry is moving at a fast pace, and almost every country now has some form of Islamic financing (Ahmad, 2015: 12-25). According to A report by The Economist Intelligence Unit (2015), population growth, increased consumer spending power, and the dominant place of Islam in Africa's demographic makeup, mean that 'Islamic economy' is playing an important role in the economic trajectory of the continent. Africa's challenges, notably infrastructure financing and the need for wider access to financial services, also provide an opportunity for the Islamic finance industry to grow (Iqbal et al. ,1998).

It is simply an accepted fact that there are sufficient Muslim investors and borrowers in both Islamic and non-Islamic countries to warrant the attention of traditional banks who seek to serve such clients are still relatively untapped market (Mohammed, 2012). Developing of Islamic financial institutions is advantageous to every economy because it enhances equitable distribute of income, operate interest free transactions and invest in only lawful investments and in real sector of the economy (Habib1992:1077-1087).

Numerous studies have been conducted worldwide in the Islamic banking sector and many studies existed in challenges and prospect of IFB. From the few studies, Iqbal et al. (1998) show that the challenges hindering Islamic banking are institutional as well as operational challenges in Pakistan, Iran and Sudan. The institutional challenges are poor institutional framework, inadequate legal framework and supervisory policies, poor supervisory framework, disparity in accounting standards, lack of equity institutions, absent of organized secondary financial market, and lack of short term market placement of funds. While the operational challenges are improper financial engineering, lack of teaching, training, research and development in this institution, lack of profit sharing finance, inability to adequately mobilize deposits, competition, and finally globalization.

Saleh et al. (2005) show the Lebanese experience with Islamic banking since the foundation of the first Islamic bank. They find that lack of public awareness and acceptance, lack of research and development institutions, inadequate manpower, and high competition from conventional banks offering Islamic windows are the major challenges of Islamic banking in Lebanon.

Amin (2008), Jabr (2003), Njanike (2010), Sanusi (2011) and different studies also show that inadequate manpower, lack of *Shari'ah*-compliant liquidity management instruments, lack of Islamic insurance (*Takaful*), lack of knowledge of accounting and auditing standard require by Islamic financial institutions, inadequate legal framework, lack of *Shari'ah*scholars knowledgeable in conventional economics, law, accounting, banking and finance, problem of multiple taxation, lack of tax relief on Islamic banking profits, and misperception are the main challenges which countries face in implementing interest free banking and Ethiopia is not an exception..

In Ethiopia few studies were conducted on the attributes of IFB. Among these studies Mohammed (2012) studied the prospects, opportunities and challenges of Islamic Banking in Ethiopia" and showed the potential challenges to be lack of awareness, regulatory and supervisory challenges, institutional challenges, lack of support and link institutions, gap in research and development in Islamic studies, lack of qualified human resource as well as wrong

association with specific religion and the global terrorism. Because the study area focused on Jijiga City and it show only on the implementation of one type of interest free product which is Safe keeping, it doesn't represent the generalized challenges and prospect in Ethiopia.

Other studies conducted by Debebe (2015) on factors affecting customers to use interest free banking in Ethiopia and by Akmel (2015) on the challenges and prospects of Islamic banking for resource mobilization in Ethiopian commercial banks showed perceived relative advantage, perceived compatibility, customers and level of awareness and subjective norm have a significant positive impact on the attitude towards interest free banking in commercial bank of Ethiopia.

Recent study on challenges on interest free banking services in Commercial Bank of Ethiopia by Kerima, (2016) show that utilization of the existing IFB products have been challenged by lack of awareness of customer, inadequate marketing and promotion, double taxation, nature of IFB products, non-provision of IFB products/services in all branches, the IFB being delivered in a Window model and lack of trust and confidence. In general the studies which are done in Ethiopia and outside Ethiopia have the same result on the challenges and prospect interest free banking. But this study does not show the prospect of IFB system.

Interest free banking is a contemporary phenomenon in the Ethiopia banking sector. As 2017 the annual report of the CBE shows from mode of IFB products the bank make available to the customer is only SAFE KEEPING, QUARD and MUDARABA. These show that there is challenge in delivering or utilizing the other mode of product. The best of my knowledge there is no study done on challenges and prospect of IFB after Mohammed study in 2012. This show not much is known about the prospects and challenges that it faces. There is a knowledge gap regarding the interest free banking practice in general and the major prospects and challenges behind the introduction of interest free banking service in the Ethiopian banking sector. So, this study fills this knowledge gap by assessing the interest free banking service of Commercial Bank of Ethiopia.

1.3 Research Questions

The study attempts to answer the following research questions.

1. What are the prospects to develop interest free banking system in CBE North Addis District?
2. What is the demand level for IFB products other than those currently provided?
3. What are the challenges which the bank and customers faces in delivering and using interest free banking?

1.4 Objectives of the Study

1.4.1 General Objective of the Study

The general objective of the study is to assess the challenges and prospect of IFB particular reference to Commercial bank of Ethiopia.

1.4.5 Specific Objective of the Study

This study specifically strives to achieve the following special objectives:

1. To examine the prospect of IFB in CBE North Addis District.
2. To assess the availability of demand for IFB products other than those currently provided by the bank.
3. To examine the challenges faced by CBE North Addis District branches and customers on delivering and using of interest free banking products

1.5 Scope and limitations of the study

1.5.6 Scope of the study

This study conducted on the challenges and prospect of IFB in banking industry in Ethiopia context. Moreover, the study area is limited to CBE North Addis District. Further, the study included only staff and customer of interest free banking business in CBE North Addis District.

1.5.7 Limitations of the study

The finding of the study will provide invaluable insights in to challenges and prospect of interest free banking system in Ethiopia. But the present study, study area is limited to CBE and branches which are located Addis Ababa city. Moreover, as it is descriptive study which does not show the case and effect of the variables, nor is it necessarily replicable by others.

1.6 Significance of the study

The study “Challenges and prospect of interest free banking” would contribute towards better understanding of the challenges and prospect of IFB which CBE face. The management of the bank and government can comprehend better the factors that influence interest free banking system in order to devise solutions. The study also direct he management of the IFB to inculcate their staff with IFB knowledge to be more competitive in the banking industry. Further this study would give direction for further study.

1.7. Organization of the Paper

This paper is organized into five chapters, the first chapter deals with the introduction of the study that is, background, statement of the problem, research questions and objective, significance, limitation and delimitation of the study. The second chapter discusses the theoretical, empirical literatures and synthesis of the literature about Interest free/Islamic Banking. The third chapter is about the methodology of the research that is the research design, sampling technique, method of data collection, data collection instruments, method of data analysis and so on. The fourth chapter of the paper presents the findings as well as the quantitative and qualitative data analysis. Finally the fifth chapter deals with the conclusion and recommendations of the study.

CHAPTER TWO

LITERATURE AND RELATED LITERATUR

This section reviews the literature written by different authors and researches conducted by different scholars in relation to the study and present a summary of challenges and prospects of IFB such as definitions, principles and major concept regarding challenge and prospects and review of empirical works. Finally the synthesis review of the study is included by summarizing the literature results.

2.1.2. Modes of Operation in Islamic Banking

In Islamic finance, the term “loan” refers only to a benevolent loan (*qard al hasan*), a form of financial assistance to the needy to be repaid free of charge. Other instruments of Islamic finance are not referred to as “loans” but rather as financing modes falling under one of the three categories: Profit-and-loss sharing (PLS), non-PLS contracts, and fee-based products Hussain, Shahmoradi, and Turk, (2015).

2.1.2. 1. *QardHasan loans or Amanah (Benevolent loan)*

It is a benevolent loan given to deserving customers by Islamic banks to alleviate poverty. The beneficiary is required by *Shari'ah* to pay back only the principal to the Islamic bank. However, the client may pay an addition to show appreciation to the Islamic bank but this intention should not be disclosed to the bank by the customer at the beginning of the transaction, Audu Bello et al.(2014). In the case that the debtor does not pay an extra amount to the creditor, this transaction is a true interest-free loan. Some Muslims consider this to be the only type of loan that does not violate the prohibition on „*riba*’, since it is the one type of loan that truly does not compensate the creditor for the time value of money, (Mohammed, 2012).

2.1.2. 2. *PLS Financing Products*

As explained in its core principles it is equity and participation, as well as it have strong link to real economic activities, help promote a more equitable distribution of income, leading to a more efficient allocation of resources.

1. Mudarabah(Silent Partnership)

A *mudarabah* contract is a financial transaction in which there are two partners in the contract. One of the partners will provide the needed capital (*Rabb-ul-Maal*) and the other partner will go into the business as entrepreneur (*Mudarib*). Audu Bello et al.(2014) and Journal of Islamic Banking and Finance 2016report show Mudharabah is one of the most well-known Islamic investments and its principles are widely adopted by Islamic banks. As Journal of Islamic Banking and Finance 2016report Mudharabah, partnership which one partner (investor) gives money for investing, while the other partner is responsible in providing labour and skill to manage the money; the profits generated out of the investment are shared in a predetermined ratio. The profit sharing ratio could be 50:50, 40:60, or 30:70, depending on the contracting parties.

2. Musharaha(Equity Partnership)

Based on Audu Bello et al.(2014) *Musharaha* is a contract in which two or more persons contribute capital for the establishment of a particular business venture in such a way that each partner has right to either involve in the administration of the business or not. However, partners may decide to be active or sleeping partner at their own will. In this kind of transaction in Islamic banking, profits are shared based on agreed ratio which need not be equal to their individual capital contribution, but loss is shared strictly based on individual capital contribution. So, Islamic bank will act as a partner in this case in order to contribute in the capital formation as well as in sharing profits and loss. Based on Ahmed (2000), Musharakah or partnership is a type of investment whereby all partners (investors) share profits of a joint venture according to a mutually agreed ratio, while losses are shared exactly in proportion to capital invested by each partner; at the same time, all partners have the right whether or not to participate in the management of the business.

2.1.2. 3. Non-PLS Financing Products

Non-PLS contracts are most common in practice. They are generally used to finance consumer and corporate credit, as well as asset rental and manufacturing, Hussain et al. (2015).

1 .Ijarah (leasing)

Under this type of investment, the owner or lessor of an asset (a motor vehicle or house) will lease out his assets to a user or lessee for a certain amount of money or rentals; and at the same

time, the ownership of the asset remains with the lessor. The aim of this kind of investment is for the investor or owner of the asset to recover the capital cost of purchasing the asset, plus a profit margin, which are obtained out of the rental payments, Ahmed (2000). As Hussain et al. (2015) a variety of *ijārah* takes a hire-purchase form, whereby there is a promise by the leaser to sell the asset to the lessee at the end of the lease agreement, with the price of the residual asset being predetermined.

2. *Bai-salam or Salam*

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

3. *Istisna'*

Istisna' is a contract in which a commodity can be transacted before it comes into existence.

The unique feature of *istisna'* (or manufacturing) is that nothing is exchanged on the spot or at the time of contracting. It is perhaps the only forward contract where the obligations of both parties are in the future. In theory, the *istisna'* contract could be directly between the end user and the manufacturer, but it is typically a three-party contract, with the bank acting as intermediary Hussain et al. (2015).

As Hussain et al (2015) explanations there are four main differences between *istisna'* and *salam* contracts.

- (i) *istisna'* involves the sale of unique manufactured goods as opposed to *salam* that can be used in standardized goods;
- (ii) unlike *salam* which requires the payment of full price up front, *istisna'* allows for spot, deferred, or even installment payments;
- (iii) an *istisna'* contract can be cancelled unilaterally until the date that the manufacturer starts working on the goods, while the *salam* contract can be cancelled only before the contract signature; and
- (iv) The time of delivery is fixed in *salam*, whereas *istisna'* can specify a maximum time for delivery after which the purchaser is no longer bound to accept the goods.

4 .Murabahah (Cost-Plus Sales Contract)

According to *Journal of Islamic Banking and Finance 2016* Just like Musharakah, Mudharabah is also a partnership, but the difference is that in Mudharabah, one partner (investor) gives money for investing, while the other partner is responsible in providing labour and skill to manage the money; the profits generated out of the investment are shared in a predetermined ratio. This type of contract is mostly used in the procurement of equipment. It is a sales contract between Islamic bank and its client at a fixed profit called mark-up. In this contract, the client will provide all the specifications of the commodity and the Islamic bank will take the risk of purchasing it for the client at a cost plus mark-up which the client can either pay in installment or sum at a spot or at a stated period.

2.1.2. 4. Fee-Based Products

The fee-based services provided by Islamic banks include bank transfers, issuing letters of credit and guarantees, credit cards, and offering collection and safe-custody services, mostly used in trade financing Hussain et al. (2015).

2.1.3. Retail Islamic Banking Products

It is division of a bank that deals directly with retail customers. In Islamic banking retail product are the following:-

1. Current Account (Alwadhiah): -The current account is basically safekeeping or Al-wadhiah' account and used for day to day cash management. In 'Al-Wadhiah', a bank is deemed as a keeper and trustee of the funds, Mohammed (2012). Current accounts are demand deposit accounts kept with the bank on custodial arrangements and are repayable in full on demand. Current accounts are based on the principle of wadia (trust or safe keeping) or amanah (trust), creating an agency contract for the purpose of protecting and safekeeping the depositor's assets. (Iqbal and Mirkahor, 2011:154).

2. Savings Account: -Islamic banks practice the principle of wadia in operating customer saving account. The bank may request permission to use customer funds deposited in these accounts as long as these funds remain within the banks discretion. The bank does not share with the customer profit earned from the use of customer funds deposited in these accounts funds but

does guarantee the customer deposits. The bank however reward customer with gift as a token of its appreciation for being allowed to use the funds. (Balla et. al (2009: 25)

3. *Investment Account:* -According to Tabir, (2007:81) Investment deposits represent the case when owners of the fund seek a return on their funds and are willing to spare these funds for an agreed period. These accounts also operate on the principle of *mudarabah*, but the modes of investment of the funds and distribution of the profits are customized to suit the needs of the clients.

2.2. Conceptual literature

According to the study made by Ibrahim (2012), the concept of Islamic Banking and Interest-Free Banking is synonymously used in Islamic Economics literature as an alternative banking framework to the interest-based conventional banking practice. However, there is a difference between an interest-free bank and an Islamic bank but they are sometimes used interchangeably. Islamic banking not only avoids interest in all its ramifications but also it avoids all other Islamically prohibited activities. Interest-free banking system on the other hand, does not engage in interest but there is no reason to suppose that all its other activities will be done strictly according to Islamic law “Shariah”.

2.2.1 Principles of IFB

As Iqbal and Molyneux (2005), Banks which participate in the Islamic banking system should follow the shariah (Islamic law) principle. This principle deals with the moral and ethical values which should be considered in dealing with business transaction. The main principles are *riba* (usury), *Gharar* (risk and uncertainty), profit or loss sharing and prohibited transaction.

1. *Riba (USURY)*

Based on the doctrine of Holy Quran which is pointed out in (2:275-280, 3: 130-132, 4:161-etc) and Hadith as *riba* (interest) is prohibited. Ali and Sarkar (1995), Islam prohibits its followers to receive or provide usury even for the purpose of getting a loan or the charged interest rate is low. In Islam, only a number of loans are allowed, such as *Qard al-Hasan*(benevolent loan), where the borrower is not charged any interest or additional incrimination on the borrowed sum.

2. Risk and uncertainty (GHARAR)

“*Gharar* means risk, uncertainty, and legal ambiguity or uncertainty that any one of the parties to a contract can exploit at the expense of the others as Khalifa M. (2016). Activities or transactions like (sale of unborn-she-camel or sheep, conditional sale, sale with loan, selling of agricultural produce before mature, selling the fish in the water etc.) are not permissible/permissive Ajagbe T. S. et al (2013). Though business transactions are generally plagued by a certain level of uncertainty, the excessive one is not welcome under Islamic finance. Hence, contracts forming the basis of business transactions and Islamic banking services should be known to a large extent about their consequence, Latifa and Mervyn (2007).

3. Profit and loss sharing (PLS)

Based on Dusuki and Abdullah (2007) study, since interest is prohibited in Islam, the providers of funds and the entrepreneur in an Islamic banking settings share the business risk and profits based on mutual agreement. This act will equitably distribute income, enhance social justice, and alleviate poverty etc. Chong and Liu (2009) also identify that a unique feature of Islamic banking is its profit-and-loss sharing (PLS) paradigm, which is predominantly based on the *mudaraba*(profit-sharing) and *musharaka*(joint venture) concepts of Islamic contracting in which the assets and liabilities of Islamic banks are integrated in the sense that borrowers share profit and losses with the banks.

4. Prohibited transactions

Islamic banking system is known as a system free of business activities that violate Sharia regulations such as investment in business related to liquor and gambling. Therefore Islamic banks in Malaysia in particular have established their own Syariah Advisory Council, which comprises Sharia experts who act as auditors and advisors to the bank. They are wholly responsible in ensuring that operations and activities of the bank do not breach the values of Islamic ethics as MohammadTaqiuddin et al. (2013).

2.2.2. Forms/Types of Islamic banking

According to Al-Jarhi and Iqbal (2001), the practice of Islamic banking, at present, takes one of the following forms:

- I. Islamic banks operating within a financial system where all banks are Islamized
- II. Islamic banks operating alongside other conventional banks and

III. Shariah- complaint branches, windows and funds established by some conventional banks.

2.2.3. Islamic and conventional banking

The main difference between Islamic and conventional banks is the use of money. In conventional banks, money is used as a commodity that is bought and sold through the interest's usage (Pasha 2014).

Table 2.1 the major difference between Islamic and Conventional banking

Conventional banking system	Islamic banking system
Charge interest on loans.	Do not charge interest. Riba (interest) is an unjust return, interest or usury. The term applies to any financial gain by the lender as a condition of a loan and in a commodity trade. It also applies to any disparity in quantity or time of delivery; as such transactions are illegal under Islamic law (Martins, 1997; Chong & Liu, 2008). Zero-return loans. Prohibits the charging or receiving of interest. A unique feature of Islamic banking is its profit-and-loss sharing paradigm, which is based mainly on the mudarabah (profit-sharing) and Musyaraka (joint venture) concepts of Islamic contracting (Chong & Liu, 2008)
Principal stakeholders are Shareholders.	The principal stakeholder is God. The aim is to serve God, while the stakeholders are the clients and the general public. Clients are partners and the decisions are in the interest of society.
Support arms industries and industries that pollute the environment and exploit children	Shariah law places restrictions on business activities. The law further prohibits trading in alcohol, tobacco, products that contain pork, defense and weapon production and certain entertainment activities like gambling and pornography (Chong & Liu, 2008)
Gives loans to whoever has a guarantor	Gives loans to those who need loans. Do not need collateral to

or collateral.	get a loan.
Decisions are made in the interest of shareholders.	Islamic principles advocate for an economic system in which all forms of exploitation are eliminated. The other principle is Mudaraba (trust Financing), a profit-sharing agreement between two parties in which one Provides the finance and the other provides entrepreneurial and management skills.
Designed for those who have money and who do not care what it is used for. Consumers have no opportunity to choose where money is invested. Provides no information about what it does with depositors' money.	Islamic banks have an interest in how the money borrowed is used. The Islamic banks have a stake in the financial activities so that money is not used for economic activities that are injurious to society. Those who lend to the Islamic banks expect the banks not to invest their money in business activities that are not Shariah-compliant. Islamic banks invest only in business activities that are Shariah- compliant.
Its investment rewards companies even if they act irresponsibly.	Islamic banks share profits and losses. Murabaha (cost-plus financing) is a contract sale between the bank and its client for the sale of goods at a price that includes a profit margin for both parties.
Designed for those who have money and who do not care what it is used for. Consumers have no opportunity to choose where money is invested. Provides no information about what it does with depositors' money.	Islamic banks have an interest in how the money borrowed is used. The Islamic banks have a stake in the financial activities so that money is not used for economic activities that are injurious to society. Those who lend to the Islamic banks expect the banks not to invest their money in business activities that are not Shariah-compliant. Islamic banks invest only in business activities that are Shariah- compliant.
Its investment rewards companies even if they act irresponsibly.	Islamic banks share profits and losses. Murabaha (cost-plus financing) is a contract sale between the bank and its client for the sale of goods at a price that includes a profit margin for both parties.
Seeks to satisfy demand. Conventional banks open branches in those areas that	Seeks to satisfy need

have sufficient demand but not needs.	
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adapted from Saidi (2007)

2.3. Empirical Literature Review

2.3.1. Empirical Literature Review-General

2.3.2.1. Prospects of Islamic banking

Early Muslims were not familiar with banking operations, and the concept of a bank as a modern institution is new to Islamic societies. Initially, many Muslims did not even understand the extent and importance of banks in their everyday lives, even if living in non-Islamic countries. However, once they realized that interest payments from conventional banking were at odds with the prohibited *riba*, they naturally looked for alternative modes of financing. Large segments of the Muslim population are underserved by conventional finance—only 24 percent of adults have a bank account and 7 percent have access to formal financing, compared with 44 percent and 9 percent, respectively, for non-Muslim populations (Demirgüç-Kunt, Klapper, and Randall 2013).

Early initiatives in the 1960s led to the establishment of Islamic financial institutions in Egypt, India, Malaysia, Pakistan, Saudi Arabia, and later in Iran and Sudan, where Islamic finance was adopted as the only financial system countrywide Nasser, (2005). It is, thus, not surprising to see that Muslims continue to look for *Shari'ah*-compliant financial institutions around the world, as these become more mature and integrated in conventional financial systems, while offering a wider range of services. The Economist Intelligence Unit report 2015 show 67% of Muslims in Sub-Saharan Africa and Ethiopia also has more than 30 million Muslims population, this looks very bright prospect of Islamic Banking. The region's Muslim population represents a potential customer base that no one can afford to ignore.

Islamic banks seem to be better placed than classical banks to absorb external shocks (Hassan & Zaher, 2001) and generate financial stability (Cihak & Hesse, 2008). The PLS system reduces the financial leverage and accordingly the risk level borne by an Islamic Bank (in the case of a financial crisis, the lower the leverage, the more likely it is that the Bank will not be able to cope

with deadlines for reduced repayments. According to The Economist Intelligence Unit report 2015, the outcome of the global financial crisis, some investors are seeking less risky investment and Islamic financial institutions have a strong financial performance record in recent years worldwide, partly due to high capitalization rates, and their avoidance of speculative activity. Moreover, countries with small Muslim populations are looking to Islamic economy activities as part of a commercial strategy, notably South Africa, whose industries have now positioned the country as a halal goods export hub for the continent.

In a study conducted by Audu Bello et al.(2014), as Challenges and Solutions to Islamic Banking System in a Pluralistic–Secular Country like Nigeria, challenges that the Islamic banks face in Nigeria are identified and solution for this challenges are provided. The result shows that the challenges are divided in two which are institutional and operational challenges. The institutional challenges are inappropriate institutional framework, inadequate legal framework, lack of equity institutions, poor supervisory framework, disparity in accounting standard, lack of secondary financial markets and lack of short-term financial instruments and institutions. The operational challenges are religious and cultural differences, lack of innovations in financial products, lack of profit sharing finance, shari’ah related issues, inadequate manpower with the requisite knowledge, lack of awareness and competition.

Study on the challenges facing Islamic financial industry by Iqbal (2001) show that limited set of short terms financial instrument and inadequate medium – to long – term financial instruments, limited coverage of Islamic finance, concentration of Islamic banking, poor risk management and governance framework, and difference between Islamic finance in theory and in practice are the main challenges which Islamic banks face.

Shaukat et al. (2011) study also show lack of ultimate authority that governs Islamic financial industry, inadequate qualified human resource in both conventional banking and Islamic laws, illiquidity of Islamic long - term assets with short - term liabilities, lack of *Shari’ah* auditing standard personnel, and shortage of short – term investment products are the challenges of Islamic banking system. They further state that the other challenges facing Islamic banking system are lack of innovation, lack of adherence to local regulatory reporting and operational

requirements, lack of transparency and accountability, operating manually, and lack of high quality services.

Study conducted by Louis S. Nkwatoh et al .(2014)examine the operational challenges of Islamic banks in Nigeria with particular reference to JAIZ International Bank Plc. The study used both descriptive and inferential methods of analysis and adopted the non-probability sampling technique. The major findings of this study are: 1) the legal framework makes very limited provision for the operation of Islamic banking in Nigeria; 2) religion, manpower and moral hazards significantly lagged the operations of Islamic banks; and 3) competition with conventional banks is a major setback to Islamic banking in Nigeria. The study concluded that operational challenges are a major setback to the performance of Islamic banks in Nigeria. In general based on different study the main Challenges and prospect of interest free banking are the following.

2.3.2.2. Challenges IFB

2.3.2.2.1. Lack of Awareness and understanding

Based on Many studies which are done in different part of the world to implement IFB religious and cultural difference which existed with in one country has influence. Audu Bello et al.(2014) One of the major challenges of Islamic banking in Nigeria has to do with the country's multiple cultural and religious belief. This issue is a serious one that needs to be effectively and efficiently resolved if Islamic banking in Nigeria must prosper. This is because of the fact that others with different cultural and religious belief will have a misperception of the institutions that may lead to not accepting the institution by the general public.

Obaidullah (2005), Brown, Hassan and Skully (2007), Louis S. Nkwatoh et al .(2014)and also others studies show that Non-Muslims see IFB as an Islamization process, while Muslims see it as an ethical act predicated on religious belief.

2.3.2.2.2. Regulatory challenges

Islamic Banking is anchored on the principles of Shari'ah (operations of Islamic banks). Momoh et al (2011), the policy framework should provide the basis for competition of Islamic banks with

conventional banks. However, this framework has been tailored in line with the conventional financial system which supports the existing conventional banking system and gives less credence to Islamic banking.

The relationship between Islamic banks and monetary authorities is a delicate one. Whatever the goals and functions are, Islamic banks came into existence in an environment where the laws, institutions training and attitude are set to serve an economy based on the principles of interest. For example, the operations of Islamic banks are on a profit and loss share basis (PLS), which actually does not come fully under the jurisdiction of the existing civil laws, (muhammed, 2012).

2.3.2.2.3. Absence of Liquidity Instruments

Financial instrument will facilitate the business sector, the absence of this system on the Islamic banking taken as challenges for its development. According to Louis S. et al (2014), the financial market in Nigeria facilitates the banking relationship existing among commercial banks through the provision of short-term tradable financial instruments: inter-bank transactions, overnight funds and borrowings that satisfy the temporary liquidity needs of commercial banks. This places Islamic banking at a distinct disadvantage compared to conventional banking, because, it operates under the norms of Shari'ah (non-interest banking). More so, there are no institutions that provide long-term finances such as bond, equity etc. on the basis of Shari'ah. There is limited knowledge of accounting and auditing standards that mirrors the specificities of Islamic products.

2.3.2.2.4. Inadequate Human Resource

Louis S. et al (2014), the sustainability of Islamic banking depends adequately on qualified human personnel, training, and above all research on Islamic finance. This is due to the increasing challenges that continuously rock the banking industry especially with the advent of technology.

They also have to understand the moral and religious implications of their investments with the business ventures. There is also a need for banking professionals to be properly trained in Islamic banking and finance. Most banks' professionals have been trained in conventional economics. They lack the requisite vision and conviction about the efficiency of the Islamic banking, (Mohammed, 2012).

2.3.2.2.5. *Lack of Supportive Institutional and Market links*

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

For example, Islamic banks, without having an interest-free money and capital market, will not have adequate instruments to meet the pre-condition for liquidity management and effective maturity transformation. So, adequate financial mechanism still has to be developed, without which financial intermediation, especially the risk and maturity transformation, will not be performed (Hassan and Skully, 2007).

2.3.2.2.6. *Shari'ah Related Issues*

Audu Bello et al. (2014), Due to the fact that Islamic banking has religious dimension, financial innovations in this institution needs to meet *Shari'ah* requirements. That is, any new financial products in Islamic banking cannot be adopted until it is approve by the *Shari'ah* advisory board and also followed by post *Shari'ah* auditing. However, this act delays Islamic banking ability to take advantage of changing financial environment due to the fact that time has to be wasted before it is finally approve by the *Shari'ah* board.

2.3.2.2.7. *Lack of research and development*

Many Islamic banks also lack the necessary expertise and institutional capacity for Research and Development (R & D) that is not only necessary for the realization of their full potential, but also for its very survival in this age of fierce competition, sophisticated markets and an informed public. Islamic banking cannot but stagnate and wither without dynamic and ongoing programmers. In addition, Islamic banks have so far not used the media appropriately. For example, even Muslims are not very much aware that the Islamic banking is being practiced in the world. Islamic banks have not ever used an effective media to the public their activities (mohammed,2012).

2.3.3. Empirical Literature Review-Ethiopian Context

2.3.3.1. IFB prospect in Ethiopia

Based on the Economist Intelligence Unit report (2015), Africa is the world's largest untapped growth market for "Islamic" commerce, spanning Islamic finance (banking, insurance, bonds and

capital markets) and halal (sharia-compliant goods and services). Islam is a dominant religion on the continent, along with Christianity, from those 67% of Muslims in Sub-Saharan Africa. A part of sub-Saharan country Ethiopia also has potential customer for IFB. Based on the 2007 national census report the Muslim population comprises 33.9% of the total population (www.csa.gov.et accessed on 12/02/2016) in Ethiopia. Therefore, the country has promise for the growth of Islamic banking.

Beyond satisfying the need of Ethiopian customers Islamic banking will also create for Ethiopian government to gain diplomatic advantages to make financial dealings with Muslim dominated nations (Usmani, 2002). It is known that Ethiopia is garnering attention for forging investors As Mohammed, (2012) introduction of Islamic banking for Ethiopian government will certainly create diplomatic advantages to make financial dealings with Muslim dominated nations especially to attract trillion dollars of equity finance from the gulf countries.

2.3.3.2. IFB challenges in Ethiopia

The development of Islamic banking start after 2008 when commercial bank of Ethiopia (CBE) start to implement Special Non-interest Savings Accounts (i.e. Special Demand Deposit), but there was no Sharia-compliant transactions up to 2013. Even though, National Bank of Ethiopia (NBE) issued a directive to banks allowing them to provide interest-free banking (Islamic banking) service using a separate window along with their other banking services, the system was started to implement only in 2013 by few commercial banks like Oromia international bank S.C, Commercial Bank of Ethiopia and united bank S.C.

NBE enacted a directive for the authorization the conventional banks to undertake an interest free banking business which is titled as “Directives to Authorize the Business of Interest Free Banking No. SBB/ 51/2011” in 2011. The Directive requires those banks that wish to get license and carry on an interest free banking service to comply with the principles of Islamic finance and standard modes of operation and fulfill some other procedural requirements.

This show in the context of Ethiopia, IFB is the recent phenomena. To the knowledge of the researcher, there appears to be very limited work on the challenges and prospect of interest free

banking in Ethiopia. These studies include the recent studies of (Kerima Ali, 2016) and (Abraham, 2017). Those studies examined the challenges on interest free banking services with particular reference to Commercial Bank of Ethiopia and determinate of customers' intention to use interest free banking products and factors affecting employees product knowledge respectively.

A study done by Mohammed, 2012 on the "Islamic Banking: Prospects, Opportunities and Challenges in Ethiopia" identified that the main challenges are lack of awareness, regulatory and supervisory challenges, institutional challenges, lack of support and institution, gap in research and development in Islamic studies, lack of qualified human resource as well as wrongful association with specific religion and the global terrorism.

Akmel (2015) study examine the challenges and prospects of Islamic banking service for resource mobilization in Ethiopian commercial banks through conducting questionnaire and Semi-structured interview for the selected three banks staff using stratified sampling. The result show that awareness, manpower, legal framework, societal belief, resource requirements as some of the challenges while economic growth, attraction of investors, and fostering investment are the likely prospects of the banks. The researcher recommended that banks need to create awareness for public acceptance and training of staffs, employ good marketing techniques, governing body need to establish clear set of legal framework, and compliance with sharia issues should be adhered.

Debebe (2015) study asses the willingness of the Ethiopian customers to use interest free banking and the factors that may influence their decision and the results showed that perceived relative advantage, perceived compatibility, customers' level of awareness and subjective norm have a significant positive impact on the attitude towards interest free banking in commercial bank of Ethiopia.

Kerima (2016) conduct study in challenges on Interest free banking services in Ethiopia with particular reference to the commercial bank of Ethiopia and this research has found out that the challenges to IFB services as: lack of commitment of the bank, lack of Shariah advisor, lack of supportive regulatory directives , Problem related to Ethiopian Commodity Exchange (ECX) law, lack of capacity to deliver IFB product at full rage, lack of awareness of customer about IFB

products, lack of trust and confidence of customers, inadequate marketing and promotion, double taxation, nature of IFB products, unavailability of IFB products in all of its branches and the IFB being delivered in a Window model.

The recent study by Abraham (2017) on determinate of customers' intention to use interest free banking products and factors affecting employees' product knowledge in the context of commercial bank of Ethiopia and the result show that except knowledge, all the other variables: attitude, social influence, perceived financial cost and religious belief have significant effect on IFB use intention.

2.4. Synthesis of the review

From the population of Africa continent, Islam is a dominant religion along with Christianity, from those 67% of Muslims in Sub-Saharan Africa. As Ethiopia is part of in Sub-Saharan countries, there will be huge opportunity for the development of interest free banking. Due to interest free banking is the a contemporary phenomenon in the Ethiopian banking sector the main challenges and prospect of interest free banking is not yet studied. The main reasons for this study is to identify the main challenges that banks face in implementing interest free banking and will helps for the banking sector to move in the solution for this challenges.

Even though, different studies mainly focused on the challenges bank face on implementing interest free banking the prospect that interest free banking have is not well studied. Also, there is research paper on challenges and prospect of interest free banking which is conducted in 2012 by Mohammed the study did not show after the implementation of commercial banks, which is the study done before the implementation of *Sharia*' compliant Islamic banks by all commercial banks. This show there is time gap because the study research tries to examine the need for *Sharia*' compliant Islamic banks and also other studies are done only single bank.

In light of the above facts and research gaps: the research and working paper that will be conducted focused on the national but not at single organization level, as well as the researcher will use qualitative method of data collection and different literature conducted on specific organization.

The purpose of this study is identifying the challenges and prospect of interest free banking in Ethiopia by selecting banks which provide interest free banking service after licensed by NBE. In terms of the methodology the researcher will use qualitative method approach using interview and questioners for data collection, descriptive research design will be applied.

To address the gap the researcher assed empirical evidence to find out the challenges and prospect of interest free banking in Ethiopia. Depending on the empirical evidence in Ethiopia the main challenges to IFB services are: lack of commitment of the bank, lack of Shariah advisor, lack of supportive regulatory directives , Problem related to Ethiopian Commodity Exchange (ECX) law, lack of capacity to deliver IFB product at full rage, lack of awareness of customer about IFB products, lack of trust and confidence of customers, inadequate marketing and promotion, double taxation, nature of IFB products, unavailability of IFB products in all of its branches and the IFB being delivered in a Window model.

CHAPTER THREE

THE RESERCH METHODOLOGY

3.1 Research Approach

According to Kothari, (2004) research design is what constitutes the blue print for collection, measurement and analysis of data. According to Creswell, (2009) there are three type of research approach, these are – Qualitative, Quantitative and Mixed Approach.

Kothari, (2004) also defined, quantitative approach involves the generation of data in quantitative form which can be subjected to rigorous quantitative analysis and it sub-classified into inferential, experimental and simulation approaches to research. The purpose of inferential approach to research is to form a data base from which to infer characteristics or relationships of population. This usually means survey research where a sample of population is studied (questioned or observed) to determine its characteristics, and it is then inferred that the population has the same characteristics. While, qualitative approach to research is concerned with subjective assessment of attitudes, opinions and behavior; and it generates results either in non-quantitative form or in the form which are not subjected to rigorous quantitative analysis through focus group interviews, projective techniques and depth interviews.

As Dawson (2003) defined qualitative research explores attitudes, behavior and experience through such methods as interview or focus groups but quantitative research generates statistics through the use of large scale survey research, using methods such as questioners or structured interviews. According to Creswell (2009, 4) definition “Mixed approach research is an approach to inquiry that combines or associates both qualitative and quantitative forms.” Keeping in view of the purpose of this study the researcher adopt Mixed approach consisting both interview and questioners techniques for data collection.

3.2. Research Design

Research design is the method and procedures for collecting and analyzing required data. The choice of research design depends on objectives of the researcher want to achieve or the research questions the researcher wants to answer (John, 2007).

According to Kothari (2004), Descriptive research includes surveys and fact-finding enquiries of different kinds. The major purpose of descriptive research is description of the state of affairs as it exists at present. This study used descriptive research design in regarding to the researcher objective which is describing the views of the respondents with regard to the challenges and prospect of interest free banking.

3.3. Population, Sampling Techniques and Sample Size

3.3.1. Target population

A population can be defined as all people or items (unit of analysis) with the characteristics that one wishes to study (Kothari, 2004). CBE has totally fifteen districts in Ethiopia based on location. Branches that are located Addis Ababa city are divided in to four districts which are North Addis, South Addis, West Addis and East Addis. To make the research manageable, North Addis district of the bank are considered in this research, which has the largest number of branches and also consist 4 special branches of the bank from those 5 branches based on their deposit and customer base. Besides, the number of branches offering IFB service stood at 70 with in this district as at of December 2017. Since the study aim is to identify the challenges and prospect of interest free banking in CBE North Addis district, the target populations are the entire IFB –employees of the CBE in North Addis district and IFB customers of the district.

3.3.2. Sampling techniques

The study population is customers and employees of CBE who use products of IFB and work at IFB windows respectively which are located in Addis Ababa city North Addis District. Questionaries' distributed for those employees who are declared to deliver interest free banking service for those sample branches and customers of the bank. Interview employed for those employees who are the head of interest free banking department with in the district and line manager of the branch. This study used multistage sampling techniques-probability and non-probability to reach at the specific respondents.

According to 2017 Commercial Bank reports Commercial bank of Ethiopia North Addis district has 106 and from those 70 branches are providing interest free banking. Among those 70 branches 53 are located with in Addis Ababa city so, those 53 branches taken as population of the study. A purposive sampling selecting procedure applied to represent the population of

branches, in which to select sample branch simple random sampling are applied. The major reason for selecting simple random sampling is that it represents the population, in which each branches has an equal probability of being selected.

3.3.3. Sampling size determination

The target population of this study is the employees and customers of commercial banks in Ethiopia North Addis district. Due to resource constraint, it is difficult to cover all branches and to keep the study manageable; however, the study will focus on branches which are located in Addis Ababa. All branches have two delegated employees who provide the service to their customers on separate window.

A sample is a small proportion of a population selected for observation and analysis. The researcher used multistage sampling techniques to determine sample branch from the districts and of respondents-customer and staff.

3.3.3.1 Branch sample size

A method developed by Carvalho (1984) has been used to determine the branch sample size. This sampling technique has been used by Debebe (2015) and Kerima (2016) while determining sample size of bank's branch. The researcher used bank's December 2017 report to obtain the total branches in these districts and accordingly as of this date there were 53branches that have IFB windows.

Table 2: Sample Size Determination

N	51-90	91-150	150-280	281-500	501-3200	1201-3200	3201-10000	10001-35000	35001-150000
Small	5	8	13	20	32	50	80	125	200
Medium	3	20	32	50	80	125	200	315	500
Large	20	32	50	80	125	200	315	500	800

Source: Carvalho (1984)

Malhortra and Peterson (2006) stated that, larger the sampling size of a research, the more accurate the data generated but the sample size would be different due to different situation. Therefore, based on Carvalho sample size determination method the researcher has selected a large sample size which is 20 branches of CBE with IFB windows in Addis Ababa North Addis District from the population of 53 bank's branches where in the larger number is considered to increase the accuracy of the data.

After determining the appropriate number of sample branches from each district, simple random probability sampling technique which is lottery method is applied to select sample branch branches. The technique is applied because the fact that the technique is simple, unbiased and it provide customers and staff with an equal chance of being selected.

3.3.3.2 Customer sample size

To determine the number of sample from the customer of the bank- a sampling technique called Small Sample Techniques from National Education Association formula has be used (Krejcie& Morgan 1970). The formula has been used by Debebe (2015), Teferi (2015) and Kerima (2016).The formula is:

$$S= X^2 NP(1-P)/d^2(N-1)+ X^2P(1-P)$$

WHERE S= required sample size, X²= Table value of X² for 1 degree of freedom as the designed confidence level (i.e. 3.8416), N= population size, P= population assumes to be (0.50 since this provide the maximum sample size), d= the degree of accuracy expressed at the proportion (0.05)

Based on the above formula, from population of 22,701IFB deposit customers sample size 385 of has been determined. Since the number of customers in each branch is not the same, the researcher used proportional computation to the number of customer in each selected branch. That is to determine the number of respondents in each branch, the proportion of each branch's customers in relation to the total number of customers considered. Thus, the number of respondents from the respective branch computed as follows:

Table 3.1. Proportional distribution of questionnaire

Category(group)based branch	Total Number of customer	percentage from total population	Total number of customer sample
Addis Ababa	775	7.6%	29
AradaGhiorgis	522	5.16%	20
Arat Kilo	543	5.37%	21
Arbegnoch	10	0.98%	4
Asko	998	9.87%	38
FerensayLegasion	90	0.89%	4
Gullele	1031	10.2%	39
Kidiste Mariam	290	2.68%	10
MehatemaGhandi	375	3.7%	14
MehalKetema	272	2.6%	10
RasDesta	306	3.02%	12
Rufael	767	7.58%	29
Semen Mazegaja	53	0.52%	2
Semen Gebeya	98	0.96%	4
Sebara Babur	406	4.01%	16
Sidist Kilo Campus	362	3.5%	14
Selassie	381	3.7%	14
Theodros	588	5.8%	22
TikurAnebessa	276	2.23%	8
Wingate	1648	16.3%	63
Yared	155	1.53%	5
Yohanness	182	1.8%	7
Total	10108	100	385

Source own survey,2018

After determining the number of sample customer from each branch, convenience sampling was used to collect data from the sample respondents. Convenience sampling is a non-probability sampling technique in which a sample is drawn from that part of the population that is close to hand, readily available, or convenient. Thus, in the selected branches questionnaire was distributed to customers on a walk in basis i.e. questionnaire is given to a customer who just arrived to get the service until the expected number of sample from the selected branch has been satisfied

3.3.3.3. Employee sample size

After sample branches are determined employee sample size determination also implemented for selecting sample from the population of staff. On the selected district the populations of IFB employee are 174 which are from IFB windows, branches line managers and IFB Department staff. The sampling from this population equals to 61 considering 40 samples are selected from IFB windows and 20 are selected from line managers and 1 IFB department head also selected. Questionnaire prepared for the staff have been distributed to the sample branches with equal number of three questionnaires for each sampled branches and one questionnaire are presented for IFB department Head. From those three distributed questionnaires for the sampled branches 2 questionnaires are for IFB staff with separate window and interview for line manager of the branch.

Table 3.2. Summary of Sampling Techniques

Sampling Unit	Sampling Size determination	Sampling Techniques
Commercial bank of Ethiopia	-	Purposive
North Addis District		Purposive
Number of sample branch	Carvalho (1984)	
Selecting Branches in the District	-	Simple random sampling Lottery method
Selection of customer from sample branch	-	Convenient sampling
Selection of sample IFB staff		Purposive

Source, own survey, 2018

3.3.4. Data Collection Techniques and Procedures

3.3.4.1. Data source

Basically there are two source of information used for research purpose – primary and secondary source. Primary source are those in which require to conduct a new survey for gathering information at different levels with regard to inquiry. Secondary source are those which are made available or have been collected for other research purpose (Adams, Khan, Raeside, and white, 2007).

For this study, the primary data was collected by interviewing the assigned line managers and department head and questionnaire also distributed for customer service officer of interest free banking in branches and customers of the bank. A questionnaire is a list of carefully structured questions with a view to exploring a reliable response from a chosen sample (Hussey and Hussey 1997). A questionnaire consists of a number of questions printed or typed in a definite order on a form of close-ended questions were used to collect the primary data for the study from selected samples in order to take the opinions of employees and customers on challenges and prospect of interest free banking. Structured interview also prepared to interviewee of interest free banking head department official and for line managers

In order to achieve the objective of the research , the researcher also used various secondary data in a bid to understand the challenges and prospects including, journal articles, various post graduate studies, banks report and internal document, and web particularly Google scholar.

3.3.4.2 Data collection instruments

The researcher adopt and modifying questionnaires used by Mohammed (2012). The questionnaire contained structured questions using a method of with 3-point scale (Agree,neutral know and Disagree). To improve the response rate, there was a cover letter explaining the reasons for the research, why the research is important, why the subjects was selected and a guarantee of the respondents' confidentiality provided.

The questionnaire has four parts, part one is about respondents' personal information. Moreover, part two is intended to measure prospects of Islamic banking. Part, the researcher used close-ended questioner by considering demand of interest free banking service to customers or

employees and part four assessed the challenges of IFB. To collect the data the researcher involved in the collection of the questionnaire in order to make the respondents feel comfortable about their response they gave and give support to rater while they are filling the questionnaire. Before distributing the questionnaire permission was obtain from branch manager and every respondent.

The other instrument used to collect primary data from the bank's IFB management team is interview. Interview method of data collection gives an opportunity to clarify any issues raised by the respondent or ask probing or follow-up questions. However, interviews are time consuming and resource-intensive. The researcher has conducted interview through a face to face contact with the respective bank officials to obtain data. The secondary data have been collected by extracting relevant and supportive data from the bank's report obtained through its database as of December 31 of year 2013 through 2017.

3.3.5. Data Analysis Techniques

The researcher has performed quantitative and qualitative analysis from responses collected on the research questions. The data that is collected by using structured questionnaire (quantitative data) are coded and analyzed using quantitative analysis with the help of Statistical Package for Social Sciences (SPSS) 20software. Descriptive statistics/analysis are used to analyze the data and the result that are presented using tables, and graphs that show the frequencies, percentages and median values which facilitate the analysis and to make it easily understandable for readers.

The qualitative data which is interview have been collected by taking written notes during the interview and tape recordings of what is said provide the raw materials for the report. The analysis is summarized and presented by interpreting the information provided by the informant and relating it to the main objectives of the study using narrative approach. On the other hand, qualitative analysis also used to triangulate some of the response obtained through close ended questions

3.3.6. Ethical Consideration

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

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

Chapter Four Data Analysis and Interpretation

4.1 Introduction

This chapter presents the results and analysis of data that were gathered from primary and secondary sources through questionnaire and interview. The collected data have been analyzed, and interpreted accordingly. As per the sampling design 385 and 40 questionnaires were distributed to IFB customers and employees of the bank respectively. From the total distributed questionnaires which distribute to IFB customers 367, 95% questionnaire were found to be completed correctly and used for further analysis and the remaining 18 questionnaires were not returned. And in addition to the questionnaire data was collected through interview and response obtained are summarized and presented accordingly.

Table 4.1: Questionnaire Response Rate

Sample	Distributed		Collected		Uncollected	
	Number	Percentage	Number	Percentage	Number	Percentage
Customer	385	100%	367	95%	18	5%
Staff	40	100%	40	100%	0	0%

Source: Own Computation from responded questionnaire, April 2018

4.2 Background Characteristics of Respondents

In this section personal profile of respondents which are collected through questionnaire have been summarized that include their qualification, Job position, religion, year of banking experience/relationship as the IFB product and/or IFB staff/customer as the case may be. Descriptive statistics has been used to analyze the demographic items as a means of describing the respondents.

The study has two types of sample which is bank's employee and customer. The employee sample constitutes two samples which are employee sub sample of customer service officer, branch manager and IFB department head.

4.2.1. Background Characteristics of Customers

1. Religion of customer

From the total valid customer response, 341 (92.9%) of the respondents were Muslims while 26(7.1%) are non-Muslim which shows the bank's majority IFB customers are Muslim.

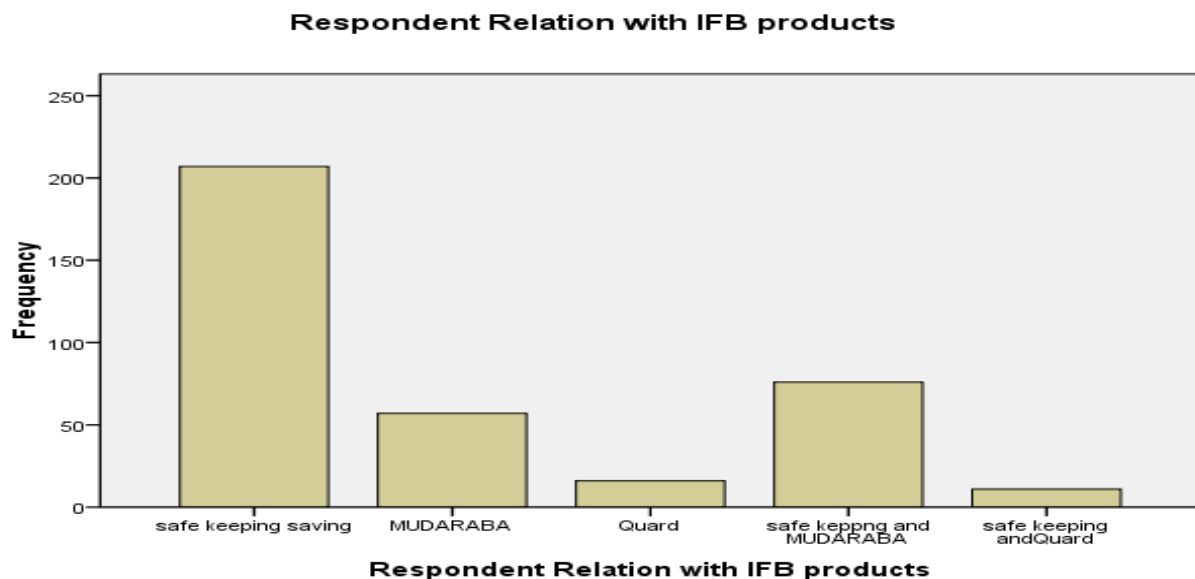
Table 4.2 Religion of respondents

	Frequency	Percent	Valid percent	Cumulative percent
Muslim	341	92.9	92.9	92.9
Non-Muslim	26	7.1	7.1	100.0
Total	367	100.0	100.0	

Source: Own computation from primary data source, 2018

2. Relation with the IFB products

Figure 4.1, Respondent Relation with IFB the product



Source: Own Computation from Primary Data Source, 2018

The researcher sought to find out customer relation with the product of IFB service which provided by CBE among the target respondents involved in the study. The findings on Figure 4.1, illustrates that 76.8% of the respondents had used save keeping saving, another 6.0% of sample customer used Qurda, 4.9% used safe keeping and qured and 3.8% of sample respondent used safe keeping and mudaraba. These analyses show that majority of the customer use safe keeping. Therefore, in delivering or utilizing the other types of products there is a challenge that the bank or customer face.

4.2.1. Background characteristics of sample staffs

Demography of the sample staff respondents was assessed to see the factual data of respondents involved in the data collection including their educational qualification, year of banking experience and exposure to interest free banking.

4.2.1.1 Educational qualification

The study sought to determine the education level of the respondents from those involved in the study. From table 4.2 revealed that the majority of the respondents 80% of are university degree graduates, followed by those of masters holders with 15% and others 5% of the respondents are diploma.

Table 4.4 Education qualification of respondent

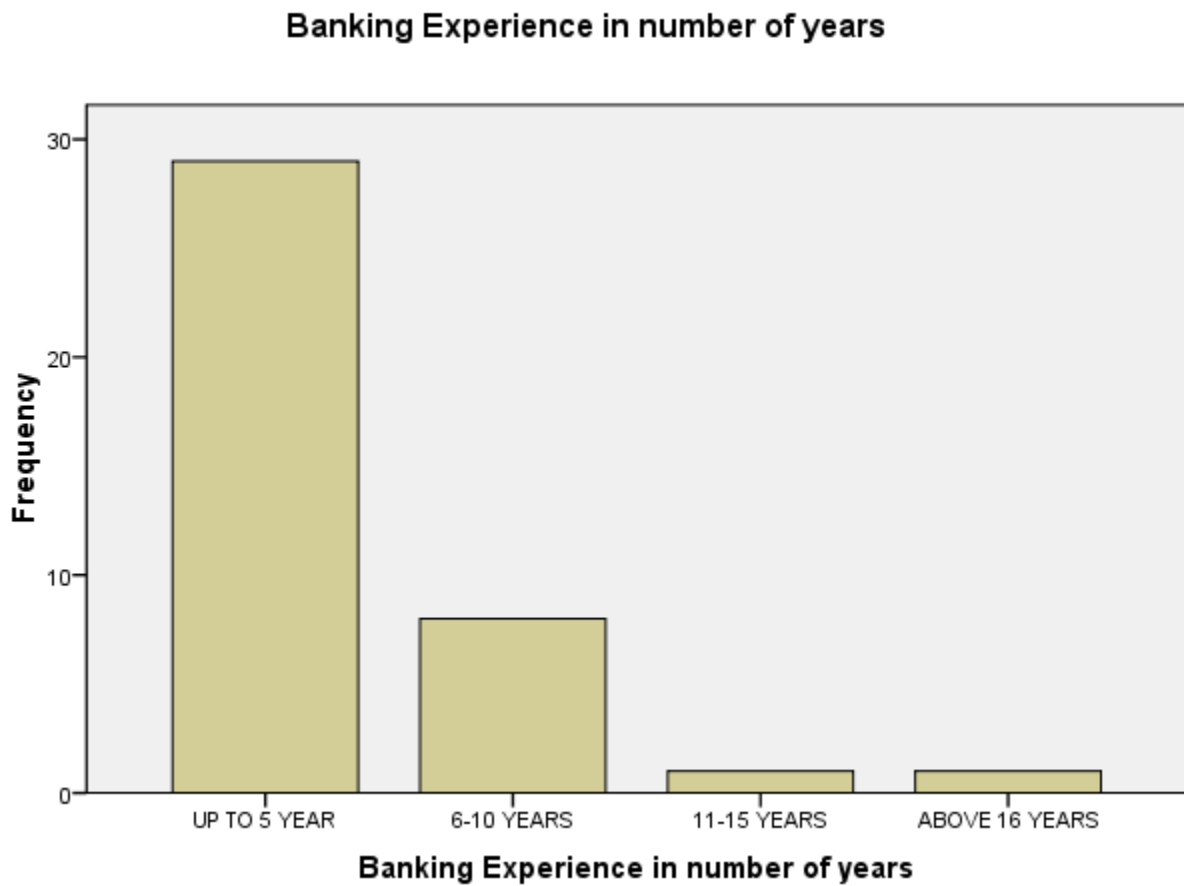
	Frequency	Percent	Valid Percent	Cumulative Percent
Valid diploma	2	3.1	5.0	5.0
BA/BSC	32	49.2	80.0	85.0
Master	6	9.2	15.0	100.0
Total	40	61.5	100.0	
Total	40	100.0		

Source: Own Computation from Primary Data Source, 2018

4.2.1.2 Banking experience

The researcher sought to find out the years of experience among the target respondents involved in the study. The findings on Figure 4.2., illustrates that 72.5% of the respondents had worked for less than 5years, another 22.5% worked between 6 to 10 years, 2.5% between 11 to 15 years, and 2.5% above 16 years of experience. This shows that most of the respondents are line staff that have direct contact with customers and real work experience and which could provide the ups and downs of IFB issues.

Figure 4.2 banking experience of respondent in number of years



Source: Own Computation from Primary Data Source, 2018

4.2.1.3 Exposure to Interest-free Banking

Table 4.3 shows that 10% of IFB staff has less than one year IFB experience and 12% have work experience 1-2year experience, 17 % of respondent has 2-3 year experience on IFB has but 60% of the respondent have above 3 year experience. This shows that most of the staff has exposure to the system with respect to the bank launch the service. Thus, data obtained from them would be fair enough to draw reasonable conclusion.

Table 4.5 staff exposure to IFB

Exposure to Interest-free Banking	Frequency	Percent
up to 1	4	10%
1-2 year	5	12%
2-3	7	17%
3-above	24	60%
Total	40	100%

Source: Own Computation from Primary Data Source, 2018

4.3.1. Prospect of IFB System

This section the analysis, the staff and customer response were used to assess the prospect of interest free banking in CBE North Addis District. Median score were applied to analyze the data. The data obtained via interview, close ended question; open ended questions and assessing secondary data. Close ended and open ended questioner were prepared for with the customer and line staff. Interview was applied for district manager, branch manager and customer service manager of the branch and the interview was analyzed by using narrative approach.

Table 4.6 Median score range

Median value	Extent of the response
0.5-1.49	Strongly Disagree
1.5-2.49	Disagree
2.5-3.49	Neutral
3.5-4.49	Agree
4.5 less than 5.49	Strongly Agree

Source: Al-Sayaad et al. (2006)

4.3.1.1. Current financial services trends in Ethiopia

One of the research questions raised by the researcher is “Current Ethiopia trends in Financial Services have positive signs on the future of IFB service in CBE”. The purpose of asking this question is to get answer for the current financial service trends in Ethiopian is one of the prospect for the development of IFB in CBE or not.

The result obtained from IFB deposit customer and staff showed that currently the financial trend in Ethiopia is one of the prospects of IFB. The detail of the results from both samples is tabulated as follows:

Table 4.7 Customers response about current financial services trends in Ethiopia

item	Statements	Sample	Response	Response Categories			Median value
				D	N	A	
1.	Current Ethiopia trends in Financial Services have positive signs on the future of IFB service in CBE	customer	F	93	18	256	4
			%	25.3	4.9	69.7	
		staff	F	10	2	28	4
			%	47.5	5	70	
2.	There is potential customer in IFB	customer	F	58	14	125	4
			%	15.8	3.8	80.3	
		staff	F	3	1	37	5
			%	5	2.5	92	
3.	Ethiopian investment policy create opportunity for Arabic country which use IFB products	customer	F	91	77	199	4
			%	24.8	21.0	54.2	
		staff	F	4	6	30	5
			%	10	15	75	

Source: Own Computation from Primary Data Source, 2018

The above table show that, based on the sample deposit customer response about Current Financial Services trends in Ethiopia, 69.7% of respondents have agreed that the current global trends in financial service have positive signs on future development of IFB service in CBE. Moreover, 70% of sample staff is also agreed about Current Financial Services trends in Ethiopia. However, 25.3% of sample customer and 47.5% of the sample staff are disagree about the prospect of the current global trends in financial service on IFB. From the total sample customer and staff 4.9% and 5% respectively being neutral.

Moreover, the descriptive statistics result shows that the median score of Current Financial Services trends in Ethiopia on the response obtained from customer and staff is 4 respectively. The result shows the value “agree”. This show the current Ethiopia trends in Financial Services pave the way for the future of IFB service development in CBE.

Table 4.7. Can clearly explain that the existence potential customer in IFB. Among the respondent, majority of the respondents of customer and staff 80.3% and 92% respectively agree that there is potential customer in IFB and, 3.8% and 2.5% of customer and staff respondents were neutral respectively. 15.8% and 5% of the customer and staff respondent were disagree with the existence of IFB potential customer. Moreover, median value 4 show respondent are agreed with the existence of potential customer. The median value 5 show of staff respondent are strongly agreed within question 2 “there is potential customer in IFB”

For question three also 24.8% and 10% of customer and staff respondents respectively disagree with Ethiopian investment policy create opportunity for Arabic country which use IFB products, and 54.2% and 75% customer and staff respondent agreed respectively, the remaining 21% and 15% of customer and staff are neutral. In addition the median value is 4 and 5 for customer and staff respondent respectively. This show customer are agreed on the Ethiopian investment policy create opportunity for Arabic country which use IFB products and staff respondent are strongly agree with the existence of investment policy which create opportunity for Arabic country which use IFB products

4.3.1.2. Interest effects on the IFB expansion

The other research questions that this study aimed to answer were effect of interest free banking service expansion on CBE. The effect of interest were assessed by using two question which focused on influence of interest in the service expansion or new investment and Muslim community reason for using conventional banking.

Table 4.8 Response from customer regarding to Interest Effects on the IFB Expansion

Statements	Response	Response Categories			Median
		D	N	A	
A plan for business expansion or new investment opportunity to be financed by bank loan cancelled due to interest based banking system	F	83	18	266	4
	%	22.6	4.9	72.2	
Muslims community who are not using conventional banking services is due to the fact that ‘Savings and loan services involve interest	F	271	48	192	4
	%	34.6	13.1	52.3	

Source: Own Computation from Primary Data Source, 2018

CBE has access potential to reach the customers IFB service. As result illustrated on the above table, concerning of business expansion or new investment opportunity cancelation due to interest based banking system 22.6% of the respondents were disagree, while 72.5% were in the agreement level. The rest 4.9% were neutral. More over the median distribution of the response was found 4, which both value show the value of “agree”. This implies IFB helps as a means to reach those potential customers who were far from the banks due to interest application.

Regarding with the statement two which focused on Muslim community customers who are far from banking service conventional banking due to interest based system majority of the

respondents 52.3% strongly agreed and agreed, while 34.6% were and 13.1% were neutral. Furthermore, the median of the distribution of the response was found 4, which the shows “agree”. This implies that properly implementing IFB answer the requests of those deprived from the conventional banking service. It is also a potential for the banks to reach customers and answer the need of those customer who don’t want interest and avoided themselves using the conventional banking service.

Table 4.9. Response summary regarding with interest effects on the IFB expansion

Statements	Response	Response Categories			Median
		D	N	A	
Customers cancelled (<i>or would cancel</i>) a plan for business expansion or new investment opportunity to be financed by bank loan due to interest based banking system	F	11	9	19	3
	%	30	22.5	47.5	
Muslims community who are not using conventional banking services is due to the fact that ‘Savings and loan services involve interest	F	12	4	24	4
	%	30	10	60	

Source: Own Computation from Primary Data Source, 2018

As illustrated in the above tables employees response rate regarding to the statement “Customers cancelled (*or would cancel*) a plan for business expansion or new investment opportunity to be financed by bank loan due to interest based banking system”, most of the respondents 30% disagree that the respondent believe customer did not cancelled or wouldn’t cancel plan of business expansion or new investment due to interest based banking system, 47.5% of them agree, and 22.5% were neutral. Moreover, the descriptive statistics result shows that the median

value 3 shows “neutral” this implies respondent are neutral on the effect of interest on customer utilization of banking products.

Many Muslim community not used conventional banking system due to its interest based system, as the result from the above table 60% of sample staff are agreed with Muslim community has not using conventional banking by its interest based banking system. 30% of sample respondent disagree. The rest of respondents which is 12.5% being neutral. The median value 4 also indicates that Muslims community who are not using conventional banking services is due to the banking services involve interest.

4.3.1.3. Demand for IFB products

One of the research questions raised by the researcher is about the level of demand for IFB products other than the currently provided one. The purpose of asking this question is to get answer for the asses the demand of customer for the other type’s products/services as prospect for the development of IFB in the bank.

1. Customers and Staff Response

Accordingly, the data found from customer response the majority of the respondents are satisfied with the existed IFB products of the bank and the demand for more IFB products is low.

Table 4.10 Customer response for demand of IFB products

Statements	Response	Response Categories			Median values
		D	N	A	
Qurda, mudarabah or safe keeping is your only priority	F	92	18	257	4
	%	25.1	4.9	70	
CBE customers demanding more IFB products	F	166	57	144	3
	%	45.3	15.5	39.3	
commercial bank of Ethiopia IFB services address the Muslim community’s need for IFB services	F	127	39	199	4
	%	34.8	10.7	54.6	

Source: Own Computation from Primary Data Source, 2018

As depicted from the above table 4.10, the majority of the respondents 70% of the customer are satisfied by the existing products and 25.1% and 4.9% of the respondent are disagree and neutral. For question two, 45.3% of respondents have said they don't want more IFB products and the other 39.3% of the respondents agree and strongly agree, and 15.5% were neutral. As question 3 response shows majority of the respondents 54.6% agreed that CBE address the Muslim community's need for IFB services and 34.8% of them disagree.

As presented on table 4.10 the median value of the three items 4, 3 and 4 respectively show that customers are satisfied with the existed products and they are not demanding more IFB products. Moreover, the median value 4 for item (1 and 3) and median value 3 for item 2 also shows the service which is delivered by the bank address the Muslim community need for IFB services and customer did not demand more IFB products.

Table 4.11 Staffs response about demand

item	Statements	Response	Response Categories			Median value
			D	N	A	
1	Qurda, mudarabah or safe keeping is your only priority	F	13	3	24	4
		%	32.5	7.5	60	
2	CBE customers demanding more IFB products	F	17	4	19	2
		%	77.5	5	17.5	
3	commercial bank of Ethiopia IFB services address the Muslim community's need for IFB services	F	16	3	21	4
		%	40	7.5	52.5	

Source: Own Computation from Primary Data Source, 2018

Table 4.11 shows, from IFB deposit staffs sample, 60% of respondents have agreed that the existed products of IFB with in the bank existing are there only priority and 77.5% disagreed that there is no demand for the other types of IFB deposit products. From the sample staff respondent 42.5% of respondents agreed that CBE address the Muslim community need for IFB service. In addition the median value 4 for both item 1 and 3 CBE address the need of Muslim community the existed IFB products and also the median value 2 for question 2 show customers is not demanding more IFB products. These indicate CBE address the Muslim community need with in the existed product and customer also not demanding more IFB products. Moreover, response obtained through open ended question further confirms the above situation, that is majority of respondents said that there is no demand/ request for additional IFB deposit products from customers.

4.4. Challenges of IFB products/Services

The other objective of this research was to identify the challenges that commercial bank of Ethiopia has faced while providing IFB products and also the challenges that customer has faced to utilize IFB products. Thus, this was set as one of the research questions to sought answer for. Both customers and staffs- line and management- of the bank have been requested about the challenges of IFB products/services that they have faced..

4.4.1 General awareness of IFB

The study tries to find out how respondents perceived Islamic banking (interest free banking).

Table 4.12 customer Response regarding awareness of the people towards IFB

Statements	Response	Response Categories			Median value
		D	N	A	
Muslim Community has awareness about IFB system	F	221	45	101	2
	%	60.2	12.3	27.5	
non-Muslims cannot use the product of IFB	F	102	21	244	4
	%	27.8	5.7	66.5	

Source: Own Computation from Primary Data Source, 2018

The output result the awareness of people towards IFB of the respondent showed that, 27.5of the respondent believed that Muslim community has awareness about IFB system by agree respectively. In addition to this 43.9% of the respondents disagree and 12.3% are neutral on the issue raised. More over the median distribution of the response was found 2 which show the value of “disagree” for item (1) respectively. Accordingly it can be concluded that the Muslim community has not awareness on IFB system.

As shown in item (2) of the table 4.12, about 66.5% of the respondents agree that the non-Muslims cannot use the product of IFB but 27.8 disagree on it. On the other hand 5.7% has neutral idea on the issue Moreover, the median value 4 also show respondents are agreed with item 2. These show that customer believe that non-Muslim community cannot use IFB products the bank should make different awareness creation methods for the customer.

Table 4.13 Staff Response regarding awareness of the people towards IFB

Item	Statements	Response	Response Categories			Median
			D	N	A	
1.	Muslim Community has awareness about IFB banking system	F	31		40	1
		%	77.5		22.5	
2.	People believe non-Muslims cannot use the product of IFB by wrong association with religion	F	14	2	24	4
		%	35	5	60	
3.	Customer have awareness about the major types of interest free banking products	F	35	2	3	2
		%	87.5	5	7.5	
4.	customers knows the Interest free banking products that currently provided by the bank	F	13	1	26	4
		%	32.5	2.5	65	

Source: Own Computation from Primary Data Source, 2018

Respondent of staff also show in the above table that, 22.5% of sample staff agree that Muslim community has awareness about IFB system. 77.5% of respondent disagree having awareness of Muslim community on IFB. The median value also shows the value “strongly disagree”.

People agree with non-Muslim community cannot use the product of IFB. Item two shows that, 60% of sample staff are agree with customer believe only Muslim can use IFB by wrong association with religion. In addition to this the median value also shows “agree” by the value 4.

In regarding to item 3 and 4, most of sample staff disagree with awareness of customer on the major types of interest free banking products by 60% respectively but 65% respondent agree with customers knows the Interest free banking products that currently provided by the bank. Behind this, 22% and 10% of the respondent are disagree and 7.5% being neutral within item (3). 32.5% and 2.5% are disagree and neutral within item (4). Moreover, the median value (2 and 3) for the last two questions respectively also confirmed that customers have not awareness about the major types of interest free banking products but they know that the products are provided by the bank. These show respondent are agreed with Muslim community awareness about IFB and people believe that the products are delivered only Muslim customer

4.4.2 Legal and Directive Issues

NBE establish laws regarding interest-free banking business and authorization the conventional banks to undertake an interest free banking business by carry on an interest free banking service to comply with the principles of Islamic finance and standard modes of operation and fulfill some other procedural requirements.

Table 4.14 Response regarding customer response on Legal and Directive issues

Item	Statements	Response	Response Categories			Mean values
			D	N	A	
1.	There is Lack of suitable banking policies for Islamic banking	F	87	63	253	4
		%	23.7	17.2	59.1	

Source: Own Computation from Primary Data Source, 2018

The assessment on Legal and Directive issues shown that from the total 367 valid respondents 65 respondents, 22 respondents, 63 respondents, 140 respondents and 113 respondents are strongly disagree, disagree, neutral, agree and strongly agree with in the lack of suitable banking policies for Islamic banking. This implies that majority 59.1 % of the respondents are agree and 23.7% of the respondent are disagree but 17.2% are being neutral. According to the perception of the respondent on Legal and Directive issues, respondent agree within the median value 4 on the Lack of suitable banking policies. This indicates that the respondent believe there is lack of suitable banking policies as of the challenge for IFB.

Table 4.15 Response regarding staff response on Legal and Directive issues

Item	Statements	Response	Response Categories			Median
			D	N	A	
1.	There is Lack of suitable banking policies for Islamic banking	F	10	0	30	4
		%	25	0	75	
2.	CBE are limited by long process approval of Shari'ah board for Innovation on IFB products	F	31	2	6	2
		%	77.5	5	17.5	

Source: Own Computation from Primary Data Source, 2018

As shown in item (2) of the table 4.15, about 25% of the respondents disagree that there is lack of suitable Islamic banking service policies in and 75% also agree on it None of the respondent has neutral idea on the issue. Moreover, the median value of the distribution of the response was found 4, which show the value of “agree”. Accordingly it can be concluded that most of the respondents agree that there is lack of suitable banking policy challenge in IFB.

As shown in item (3) of the table 4.15, about 17.7% of the respondents agree that there CBE are limited by long process approval of Shari'ah board for Innovation on IFB products. In contrary to this 77.5% disagree on it. On the other hand 5% has neutral idea on the issue. Moreover, median value of the distribution of the response was found 2, which shows value of “disagree”. Accordingly it can be concluded that the long process approval of Shari'ah board for innovation of IFB products are not challenge for IFB development.

4.4.3. Supportive Financial Institution and Market Potential

In conventional commercial banking, medium term and long-term finance is provided through long-term bonds and equities. Without deposits collected from the general public, the important source of these long-term investments are investment banks, mutual funds, insurance companies and pension funds, but Islamic banks do not deal with interest bearing bonds. Therefore, there is a need for the same supportive financial markets are necessary (Akmel, 2015).

Table 4.16 Response regarding staff response on Supportive and financial institution

Item	Statements	Response	Response Categories			Median value
			D	N	A	
1.	Lack of institutions like Interest free Money Market and capital markets would create liquidity and other operational difficulties to Islamic Banking	F	13	1	26	4
		%	32.5	2.5	65	
2.	There is a lack of supportive and link institutions such as Shar'iah boards and consultancies for successful practice of Islamic Banking and Finance	F	14	2	24	4
		%	35	5	60	

Source: Own Computation from Primary Data Source, 2018

As a result found shown in item (1) of the table 4.16, about 32.5% of the respondents disagree about the liquidity and other operational difficulties due to the lack of financial institution. In addition to this 2.5% respondent has being neutral to the issue. 70% disagree respectively on the issue raised. More over median distribution 4 for also implies that lack of institutions is a challenge for the banking sector development which creates liquidity and other operational difficulties to Islamic Banking.

On this issue there is also found response from open ended questions the staffs. According to the respondents the lack of financial institution which supports IFB is a challenge for the banking sector development because of not founding supporting financial institution for gaining

additional financial resource when they require the fund beyond their existing liquidity problems. Accordingly it can be concluded that the Lack of institutions like Interest free Money Market and capital markets create liquidity and other operational difficulties to the banks.

As shown in item (2) of the table 4.16, about 60% of the respondents agree respectively that there was a lack of supportive and link institutions such as Shar'iah boards and consultancies. 5% has neutral idea on the issue. On the other hand 2.5% and 32.5% of the respondents were indifferent by d disagree respectively on this respect. Moreover, the median value of the distribution of the response was found 4, which indicate that most of the respondents are agreed with it. Accordingly it can be concluded that most of the respondents strongly agree there was lack supportive and link institutions such as Shar'iah boards and consultancies challenge for successful practice of Islamic Banking and Finance.

4.4.4. The status of Islamic banking in research & development training

Compared to conventional banking concepts, Islamic banking is a very new discipline and has distinct rules and principles. This implies for a need of training in the procedures and principles of Islamic banking which would further accelerate the growth of the sector.

Table 4.17.customer response on the status of Islamic banking in research & development and resource constraints

Item	Statements	Response	Response Categories			Median
			D	N	A	
1.	There is a gap in research and development in Islamic studies in general and Islamic finance and economics in particular	F	100	84	183	3
		%	27.2	22.9	49.2	
2.	CBE have enough qualified human resource in Islamic banking to ensure that Islamic banking Services are up to date and fully comply with Sha'riah law	F	68	17	30	2
		%	59.1	14.8	26.1	

Source: Own Computation from Primary Data Source, 2018

The above table show that, based on the sample deposit customer response about status of Islamic banking in research & development and resource constraints, 49.2% of respondents have agreed that there is a gap in research and development in Islamic studies; furthermore 27.2% disagreed that CBE have enough qualified human resource in Islamic banking. Moreover, the descriptive statistics result shows that median score of status of Islamic banking in R&D is 3 this show it is closer to the value “neutral”. Based on the 49.2% of respondent agree and median score show” neutral”, customer agree with the lack of research and development in Islamic finance. For human resource constraints item (2), based on the median obtained from respondent is 2 this shows lack of qualified human resource in Islamic banking with in CBE one of the challenge for the bank to deliver the IFB products.

Table 4.18. staff response on the status of Islamic banking in research & development and resource constraints

Item	Statements	Response	Response Categories			Median values
			D	N	A	
1.	There is a gap in research and development in Islamic studies in general and Islamic finance and economics in particular	F	9	2	29	4
		%	22.5	5	72.5	
2.	CBE have enough qualified human resource in Islamic banking to ensure that Islamic banking Services are up to date and fully comply with Sha’riah law	F	16	2	22	4
		%	40	5	55	
3.	There is lack of training in IFB system	F	6	0	44	4
		%	15		85	

Source: Own Computation from Primary Data Source, 2018

As a result found shown in item (1) of the table 4.18, about 72.5% of the respondents agree about gap in research and development in Islamic finance and economics. 5% respondent being neutral to the above issue and 22.5% disagree respectively on the issue raised. Moreover, the median of the response was found 4 which indicate the value of “agree”. Accordingly gap in research and development in Islamic finance can be concluded that it is a challenge for the banking sector development.

As presented on table 4.18 item 2 and 3 respondent believe that CBE have enough qualified human resource in Islamic banking to ensure that Islamic banking Services are up to date and fully comply with Sha’riah law and there is lack of training in IFB system with in the bank with the median value 4 for both items. From the total respondent 40% and 5% are disagree with CBE have enough qualified human resource in Islamic banking. 40% and 15% of the respondents agree and strongly agree respectively with in the above respective idea. And 5% are being neutral. 15% of the respondent are disagree with lack of training in IFB system. From those 85% of the respondent are agree with lack of training.

In addition to this, open ended question show lack of qualified human resource and training program on IFB system create knowledge gap with in the staff to deliver the service. Employees who deliver the service did not get sufficient training while; they provide the service based on their conventional banking experience. Most of the respondent believes that the large number of the staff did not have enough knowledge on the types of IFB products. These show that not providing training service become challenge to deliver the product.

4.5. Analysis of data from both qualitative and quantitative interview

The qualitative interview on the challenges and prospect of IFB is analyzed by using narrative approach and presented below.

4.5.1. Prospect of IFB

- One of the most important prospects of Islamic Banking is the existence of potential customer of IFB financial service of the bank in Ethiopian, Muslims community. As Mohammed (2012) study show the non-availability of interest-free banking products results, many Ethiopians, including those in the economically disadvantaged strata of society, to be excluded from financial services due to reasons of their faith.
- Ethiopia is a developing country and needs huge investments. Investment framework is favorable in Ethiopia. Ethiopia's legal framework, which is the best and it protects foreign investors. Also, the economies of neighboring Islamic countries have limited opportunities to invest their country. Ethiopia has abundant human resource and labor force too. Introduction of Shariah-compliant banking will bring more Arab petrodollars into the country.

4.5.2. Challenges IFB Products

The main objective of this research was to identify the challenges and prospect that commercial bank of Ethiopia has faced while providing IFB products and also the challenges that customer has faced to utilize IFB products. The challenges to utilized IFB by customers are identified by the customers by using distributing questioners to sampled customer. But the challenges which hindered IFB products from being delivered are identified by using structured interview to the line manager of the bank and IFB department manager. Both IFB department manager and branch manager of the bank have been requested about the challenges of IFB products/services that they have faced. The researcher has summarized the identified challenges as follows.

4.5.2.3. Challenges to deliver interest free banking

Absence of equity markets

In a conventional system, this is provided through long-term bonds and equities. This function is performed by securities markets and specialized equity institutions. In addition to the general public, the most important sources of these investments are investment banks, mutual funds, insurance companies and pension funds. Islamic banks do not deal with interest-bearing bonds

and therefore the need for equity markets is much higher in an Islamic framework. According to the respondents, non-interest bearing equity markets

Lack of Shariah advisor

According to Pasha (2014) IFB shall comply with Shariah law, which means bank's products and services and even its transaction and business activity has to be in line with the principles and law stipulated in Shariah. But as the response of the bank officials there is no Shariah advisor board

Lack of supportive supervisory directive or Regulatory challenges

In delivery of IFB products supportive supervisory directive is taken as challenges. The directive does not consider the nature and requirements of IFB operation. The Islamic banks are regulated by the same framework as that of conventional banks except related to interest. According to Article 3 of limitation on investment of bank, directive SBB/12/1996, "A bank may hold shares in a non-banking business only up to 20% of the company's share capital and total holdings in such business shall not exceed 10%". This article creates a conflict for issuing Musharaka financing partnership agreement in which a bank could own majority of the share of a business/transaction at the time of the signing of the contract. Thus, this directive hinders the delivery of this product at all. In addition to this the IFB directive does not give detail guide line and there is also weak support and follow up from NBE.

Beyond this, government approves one window service and there no legal frame work issued for a full fledge interest free banking currently, IFB products in Ethiopia are being delivered through a window model which has created inconveniency and has affected the customers' trust negatively. Majority of the customer would like to obtain IFB service on a branch model or fully fledged model.

Lack of awareness and understanding

Availability of less number of customers is one of the obstacles and limits the bank to be the existed one. As the respondent of the officials show that some banks may not deliver the service even for one customer with in the whole day because of unavailability of customer. As

the response of the bank officials, customers did not have trust if the product is delivered by non-Muslim staff and customer also believed that the service which it is delivered by the bank based Shariah compliant IFB product and services. As the response of bank officials, customers believed that there is mixing of IFB and conventional banking transaction and the bank is not even committed to give truly IFB services this has eroded the customers' trust.

4.5.2.4. Challenges to utilize interest free banking

Unavailability of IFB products/services in all of its branches

As the response show customers are CBE does not provide IFB to its all branches. And the response also show customer complain on not providing the service in all branches of the bank these can be taken as challenges to utilize the products by the customer.

Unequal Treatment of Debt and Equity and Double taxation

Under the existing rules in Ethiopia, interest is exempted from tax while dividends are taxed. In an Islamic financial institution, the capital is equity based as it is operating through profit and loss sharing. This therefore is a big disadvantage for Islamic financial companies as compared to other conventional financial firms. As a result of this buying and reselling of asset, double taxation occurs. The bank will pay tax when owning the asset and customer will also pay tax when buying the asset.

Lack of trust with in the bank

The result of the respondent of the bank officials indicated that customer believed that IFB the service which is provided by the bank are not fully separated from the conventional banking system. Customers are not satisfied with window based IFB service of the bank. The majority of the respondent of the staff show that in some branches there is only one IFB customer service officer these create gap to deliver the service when IFB CSO staff is absent or in lunch time. Conventional window also deliver the service to the customer or customer will returned without getting the service. Mix of IFB and Conventional banking create complain with in the service that the customer to utilize and keep separate book account.

Generally the major challenges to deliver and utilize interest free banking are regulatory challenge, lack awareness and understanding, Lack of Shariah advisor, Lack of supportive supervisory directive, undeveloped Islamic primary market and non-existence of secondary market for Islamic product are some serious problems of to deliver IFB with in the bank.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

CONCLUSION

The objective of the study was to assess the challenges and prospect of interest free banking to utilize and deliver. Accordingly the study assessed the types of interest free banking products used by CBE. Moreover, the demand levels for IFB products other than those currently provided by the bank are assessed.

The finding of the study particularly showed that the Current financial service trends in Ethiopian and large marketing opportunity of interest free banking have positive signs on the future of IFB service Islamic banking in Ethiopia. Even if there is potential customer Customers are satisfied with the existed Interest free banking products and there is no demand/ request for additional IFB deposit products from customers. In the utilization of IFB products, double taxation, non-provision of IFB products/services in all branches, the IFB being delivered in a Window model, lack of trust and confidence qualified human resource in Islamic banking are the major challenges.

According to the respondents even though long process approval of Shari'ah board for innovation of IFB products cannot be challenge for IFB development, there is lack of suitable banking policies and comprehensive legal framework, lack of awareness, lack of equity market, lack qualified human resource in Islamic banking, lack of trust by the customer, unavailability of IFB products in all branches and Unequal Treatment of Debt and Equity and Double taxation are some major obstacles that to deliver and utilize the service.

The current study examines the challenges and prospect of IFB in commercial bank of Ethiopia North Addis District. It gives hindsight for the staff and management of Commercial bank of Ethiopian towards Interest free banking challenges and prospect. The contribution of this study is vital as it has identified the major prospect for the development of IFB system and challenges deliver and customers to deliver and utilize IFB products. However, the study is bounded by both

area coverage and problem addressed. Therefore, future studies can be conducted with wider scope and the effects of these challenges on the success of IFB.

RECOMMENDATION

Based on the research finding the following recommendation are provided in order to enhance prospect, the delivery and use of IFB products in Ethiopian banking market .

- Currently the Islamic banks are regulated by the same framework as that of conventional banks. Since the two banking systems work differently, many issues of Islamic banking cannot be settled by the existing policy. A compatible regulatory framework will create a path for Islamic banks to compete freely with conventional institutions. NBE also should consider giving IFB products in separate facility, at least in dedicated branches of the conventional bank, in order to improve attitude and increase IFB adoption.
- Most of the training given to the staff of banks is in line with the conventional banking system. Compared to conventional banking concepts, Islamic banking is a very new discipline and has distinct rules and principles. This implies for, a need of training in the procedures and principles of Islamic banking which would further accelerate the growth of the sector. The bank needs to adopt comprehensive and regular training on the IFB products and service for those staff who are engaged in providing the service.
- The bank should have aggressive promotion and marketing campaign about IFB products to create awareness on IFB products by particularly towards the target market (the Muslim community) must be done consistently by using several promotional campaigns should be planned like poster, banner, media, and etc.
- Alongside awareness creation, bank has to build the trust and confidence of its customer by being transparent/disclose all its products, transaction and its IFB business activity to the public and confirm they are in line with Shariah. To support this action further the bank immediately has Shariah advisors. According to Pasha (2014) perception of Muslims that is the trust and confidence about the existing practice of IFB is truly of Shariah compliant and not a copy of the conventional banking with a banner of Shariah compliant is very important issue for IFB existence and success.

- The Bank has to increase the accessibility of IFB products through increasing IFBW at customers' convenience and avail its products/services in all branches with the necessary facility that will increase the marketability of IFB products/services.
- The bank should work with sharia advisory board to come up with relevant regulations governing the operation of Islamic banking (interest free banking) that conforms to the principles

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Appendix A. Customer Questioner in English

St. Mary's University

School of Graduate Studies

Department of Masters of business Administration

Dear Respondents, I am conducting research on “challenges and prospect of interest free banking with particular reference to commercial bank of Ethiopia North Addis District” as a partial fulfillment of MBA study at school of graduate studies, St. mary's university. The main objective of this research is to investigate what are the challenges of interest free banking in relation to the delivery and use of its products and its prospect. For the successful accomplishment of the study, your response will have a pivotal role by providing valuable input for the study. Thus, your genuine and honest response is very crucial for attaining the aim of the research and the researcher would like to thank you for your cooperation in advance.

Attention

- No need to write your name
- Instruction for each part of the questionnaire is given at the beginning of the questions
- Kindly respond to all questions

Thank you in advance for your cooperation

Part one: Background Information Dear respondents, please label a characteristic that correspondent to your background data by using “√” mark.

1.1 religion of customer:

Muslim

Non-Muslim

1.3 relations with the product:

safe keeping saving

qured

mudaraba

safe keeping and qured

safe keppng and qured

safe keeping and

mudaraba

qured and mudaraba

all

1. Prospect of IFB

Items	Agree 1	Disagree 2	I Do not Know 3
Current Ethiopia trends in Financial Services have positive signs on the future of IFB service in CBE			
Dou you believe there is potential customer in IFB			
Ethiopian investment policy create opportunity for Arabic country which use IFB products			
Your plan for business expansion or new investment opportunity to be financed by bank loan cancelled due to interest based banking system			
you are not using conventional banking services is due to the fact that 'Savings and loan services involve interest			

2. Demand for IFB products

Items	Agree 1	Disagree 2	I Do not Know 3
Qurda, is your only priority choice			
mudarabah is your only priority choice			

safe keeping is your only priority choice			
commercial bank of Ethiopia IFB services address the your need for IFB services			
You demanding more IFB products			

3. Challenges of IFB

Items	Agree 1	Disagree 2	I Do not Know 3
Muslim Community has awareness about IFB system			
non-Muslims cannot use the product of IFB			
There is Lack of suitable banking policies for Islamic banking			
There is a gap in research and development in Islamic studies in general and Islamic finance and economics in particular			
CBE have enough qualified human resource in Islamic banking to ensure that Islamic banking Services are up to date and fully comply with Sha'riah law			

Appendix A. 2 Customer Questioner in Amharic



የተከበራችሁ የ ባንኩ ደንበኞች

ይህ መጠይቅ በትድስት ማርያም ዩኒቨርሲቲ የቢዝነስ አመራር የማስተርስ ድግሪ ተማሪ የተዘጋጀ ሲሆን አላማው የመመረቂያ ጽሁፍ ማሞያነት የኢትዮጵያ ንግድ ባንክ ስለሚሰጠው ከወለድ ነጻ የባንክ አገልግሎት መረጃ ለማሰባሰብ ይሆናል ። መረጃው የሚያገለግለው ለጥናቱ ርዕስ “ከወለድ ነጻ ለባንክ አገልግሎት ላይ የተሸሻለ እድገት ሊፈጥሩ የሚችሉ እና ተግዳሮት ሊሆኑ የሚችሉ ጉዳዮች” የሚል ነው ። የሚሰበሰበው መረጃ ለጥናቱ አገልግሎት ብቻ የሚውል ይሆናል። ስለዚህም እርሶ መጠይቁን በትክክል በመሙላት ጥራት ያለው የጥናት ውጤት እንዲዘጋጅ በመጠይቁ ላይ የተዘረዘሩትን ጥያቄዎች በትዕግስት እንዲመልሱልኝ እጠይቃለሁ ።

ከዚህ መጠይቅም ሆነ ከጥናቱ ርዕስ ጋር በተያያዘ ጥያቄ ቢኖሮት ከታች በተጠቀሰው አድራሻዬ እንዲያሳውቁኝ እጠይቃለሁ። በተጨማሪም ለትብብር ምስጋናዬንና አድናቆቴን በቅድሚያ እገልጻለሁ።

የውብዳር ጌታቸው

ኢሜል yobigech@gmail.com

ስልክ ቁጥር 0920481498

መደብ አንድ፡ የግል መረጃ

መልስ ይሆናል ብለው ያሰቡትን ቁጥር ያክብቡ።

ተ.ቁ	ጥያቄ	አማራጮች
የትኛው የሀይማኖት ክፍል ውስጥ ኖት	1.መ.ስሊም	1
	2.መ.ስሊም ያልሆነ	2
ከየትኛውን ከወለድ ነፃ ሂሳብ ጋር ትስስር አለዎት?	አደራ	1
	መ.ዳረባህ	2
	ቕርዳ	3
	የአደራ ና መ.ዳረባህ	4
	የአደራ ና ቕርዳ	5
	መ.ዳረባህ ና ቕርዳ	6
	በሁሉም	7

ክፍል አንድ

ይህ መደብ ከወለድ ነጻ የባንክ አገልግሎት ላ የተሻለ ድገት ሊፈጥሩ የሚችሉ ጉዳዮች ይዳሰሳል።

ስለዚህ እንደስምምነታችሁ የተሰጠውን ዓ/ነገሩን ከታች በቀረቡት አማራጭ መሰረት አክብቡ።

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

ተ.ቁ	ዋና ሃሳብ	አማራጮች				
		በጣም አልስማማም	አልስማማም	ገለልተኛ	እስማማለሁ	በጣም እስማማለሁ
1.	በአሁኑ ወቅት በ ሀገሪቱ ላይ ያለው የፋይናስ እንቅስቃሴ ወደፊት በኢትዮጵያ ንግድ ባንክ ውስጥ ላለው የወለድ ነጻ የባንክ አገልግሎት በጎ አስተዋጽኦ ይፈጥራል።					
2.	በኢትዮጵያ ያለው ከወለድ ነጻ የባንክ አገልግሎት የሙስሊም ማህበረሰቡን የፋይናስ እንቅስቃሴ አነቃቅቶአል።					
3.	በአሁኑ ወቅት በባንኩ የሚሰጠው ከወለድ ነጻ የባንክ አገልግሎት ማለትም የቁጠባ የብድር አገልግሎት ለንግድ ስራ ማስፋፊያ ለ ኢንቨስትመንት ማንቀሳቀሻ የሚሆን አቅም መፍጠር የሚችል ነው ።					
4.	አብዛኛው መስሊሙን ማህበረሰብ ያለውን መደበኛ					

	<p>የባንክ አገልግሎት የማይጠቀሙት በቁጠባ ና የብድር አገልግሎት ላይ ወለድ በመኖሩ ምክንያት ነው።</p>				
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ክፍል ሁለት

ይህ መደብ ከወለድ ነጻ የባንክ አገልግሎት የደምበኖች ፍላጎት ይዳስሳል።

ስለዚህ እንደ ስምምነታችሁ የተሰጠውን ዓ/ነገሩን ክታች በቀረቡት አማራጭ መሰረት አክብቡ።

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

ተ.ቁ	ዋና ሃሳብ	አማራጮች				
		በጣም አልስማማም	አልስማማም	ገለልተኛ	እስማማለሁ	በጣም እስማማለሁ
1.	አደራ ፣ ሙዳረባህ ና ቆርቋ ከወለድ ነጻ የባንክ አገልግሎት ብቸኛ ምርጫዎት ነው።					
2.	የ ኢትዮጵያንግድ ባንክ ከወለድ ነጻ የባንክ አገልግሎት የሙስሊሙን ማህበረሰብ የወለድ ነጻ የባንክ አገልግሎት ፍላጎት አምዋልቶል።					
3.	ባንኩ አሁን ከሚሰጣቸው ከወለድ ነጻ የባንክ አገልግሎት አይነቶች ተጨማሪ የአገልግሎት አይነቶች ይፈልጋሉ ።					

ክፍል 3

ይህ ክፍል ከወለድ ነጻ የባንክ አገልግሎት ላይ ተግዳሮት ሊሆኑ የሚችሉ ጉዳዮችን ይዳስሳል ።

ተ. ቁ	ዋና ሀሳብ	አማራጮች				
		በጣም አልስማማም	አልስማማም	ገለልተኛ	እስማማለሁ	በጣም እስማማለሁ
1.	ስለ ከወለድ ነጻ የባንክ አገልግሎት ግንዛቤ አለዎት ።					
2.	ከወለድ ነጻ የባንክ አገልግሎት ለሙስሊም ማህበርሰብ ብቻ የተዘጋጀ ነዉ ።					
3.	ከወለድ ነጻ የባንክ አገልግሎት ላይ ጥናታዊ ጽሁፎች ና ምርምር ክፍተት አለ ።					
4.	የኢትዮጵያ ንግድ ባንክ የሽሪያ ህጉን ጠብቀው የሚሰሩና ብቁ የሆነ የሰው ሃይል አለ።					
5.	ከወለድ ነጻ የባንክ አገልግሎት ጋር የሚስማማ የህግ መዋቅር አለ።					

Appendix B Questionnaire for Bank Employees

St. Mary's University

School of Graduate Studies

Department of Masters of business Administration

Dear Respondents, I am conducting research on “challenges and prospect of interest free banking with particular reference to commercial bank of Ethiopia North Addis District” as a partial fulfillment of MBA study at school of graduate studies, St. mary's university. The main objective of this research is to investigate what are the challenges of interest free banking in relation to the delivery and use of its products and its prospect. For the successful accomplishment of the study, your response will have a pivotal role by providing valuable input for the study. Thus, your genuine and honest response is very crucial for attaining the aim of the research and the researcher would like to thank you for your cooperation in advance.

Attention

- No need to write your name
- Instruction for each part of the questionnaire is given at the beginning of the questions
- Kindly respond to all questions

Thank you in advance for your cooperation

Part one: Background Information Dear respondents, please label a characteristic that correspondent to your background data by using “√” mark.

1.2 Educational qualification:

Diploma BA/BSC Master's Degree PHD

1.2 Current Job Position in the bank: _____

1.3 Banking Experience in number of years:

Up to 5 years 6-10years 11-15 years above
16 years

1.4 Exposure to Interest-free banking:

Up to 1 1-2 year 2-3 year 3-above

1. Prospect of IFB

Items	Strongly disagree 1	Disagree 2	Neutral 3	Agree 4	Strongly Agree 5
Current Ethiopia trends in Financial Services have positive signs on the future of IFB service in CBE					
There is potential customer in IFB					
Ethiopian investment policy create opportunity for Arabic country which use IFB products					
A plan for business expansion or new investment opportunity to be financed by bank loan cancelled due to interest based banking system					
Muslims community who are not using conventional banking services is due to the fact that 'Savings and loan services involve interest					

2. Demand for IFB products

Items	Strongly disagree 1	Disagree 2	Neutral 3	Agree 4	Strongly Agree 5
Qurda, mudarabah or safe keeping is your only priority choice					
commercial bank of Ethiopia IFB services address the					

Muslim community's need for IFB services					
CBE customers demanding more IFB products					

3. Challenges of IFB

Items	Strongly disagree 1	Disagree 2	Neutral 3	Agree 4	Strongly Agree 5
Muslim Community has awareness about IFB system					
People believe non-Muslims cannot use the product of IFB by wrong association with religion					
Customer have awareness about the major types of interest free banking products					
customers knows the Interest free banking products that currently provided by the bank					
There is Lack of suitable banking policies for Islamic banking					
Lack of institutions like Interest free Money Market and capital markets would create liquidity and other operational difficulties to Islamic Banking					

There is a lack of supportive and link institutions such as Shar'iah boards and consultancies for successful practice of Islamic Banking and Finance					
There is lack of training in IFB system					
There is a gap in research and development in Islamic studies in general and Islamic finance and economics in particular					
CBE have enough qualified human resource in Islamic banking to ensure that Islamic banking Services are up to date and fully comply with Sha'riah law					

Part Five: Open ended question

1. What do you think are the challenges that interest free banking products user face?

2. . What do you think the challenges that the bank has faced to deliver Interest free products?

3. . If you have any opinion, comment regarding the challenges on the delivery and use of

Thank You

Appendix C: Interview Question

Interview Question for bank management by Yewubdar

1. What do you think about the current status of interest free banking in Commercial bank of Ethiopia?
2. What type of interest free banking products does the banking currently made available to its customers? Does customer request/demand for other IFB product that the bank currently not providing?
3. Does the bank face any challenges to deliver interest free banking products?
4. What do you think about support from government body on initiation, government regulation, policy and procedures needed on IFB provision and expansion?
5. As the IFB is in accordance of sharia law do you believe non-Muslim accept sharia law and adopt these services? Is there non-Muslim customers in your bank those used these services?
6. As your bank keep separate book account and windows in respect of IFB operation, do your bank trusted by customers as there is a proper maintenance of records for all transactions for segregation of funds or activities from conventional one? What do you think the challenges that interest free banking products user face on utilization IFB product