



**ST MARY'S UNIVERSITY  
SCHOOL OF GRADUATE STUDIES**

**ASSESSMENT OF CHALLENGES AND OPPORTUNITIES  
OF ISLAMIC BANKING AT SALAAM AFRICAN BANK**

**BY:**

**ZAHRA ALI FARAH (SGS/0035/2009B-B)**

**JANUARY, 2019**

**ADDIS ABABA, ETHIOPIA**

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BANKING THE CASE OF SALAAM AFRICAN BANK**

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**A THESIS SUBMITTED TO ST MARY'S UNIVERSITY SCHOOL  
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**January, 2019**

## **DECLARATION**

I, Zahra Ali Farah with an I.D. Number of SGS/0035/2009B\_B, do hereby declare that this Thesis is my genuine work and has never been submitted partially or in full by any person to any institution and that all sources of materials used for this thesis have been properly acknowledged.

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**St. Mary's University, Addis Ababa**

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## Abstract

*This study was conducted at headquarter of Salaam African Bank in Djibouti. The main purpose of this study was to assess the challenges and opportunities of Islamic at SAB. The research design used was descriptive research design and the research approach employed was quantitative. Quantitative research approach was appropriately used in the study because; mainly primary data was used and collected through questionnaire from the HRD in Salam African Bank. To do so, the researcher selected 111 employees from the total employees of 150 as a sample based on simple random sampling technique using lottery method. After the data were collected, it was analyzed in quantitative method of data analysis through the use of SPSS version 20 and the statistical analysis was made such as descriptive statistics, The findings of the study reveal that , the lack of expert that studies Islamic banking system was the highest challenges among other in Salam African Bank. However the highest opportunity was that Islamic financial industry is growing with the entrance of new Islamic bank and every conventional bank open Islamic window. The study finding indicated that most employees were not well trained, also findings indicating a weak level of supervisory and government support. The researcher concluded that the lack of expert and lack of awareness inside the society can restrain the growth of Islamic Banking System. Therefore the researcher recommends that: employees must be well trained to attract more users of Islamic Banking and they must be well known expert to studies Islamic Banking System.*

*Key word: Islam, Challenge, Opportunity, Training, Employees, Government, Supervisory*

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## ***Abbreviations/ Acronyms***

- IFB: .....Interest Free Banking*
- IBS: ..... Islamic Banking System*
- IB: .....Islamic Banking*
- IDB: .....Islamic Development Bank*
- SAB: .....Salaam Africa Banking*
- CB: .....Conventional Bank*
- SPSS: .....Statistical Package for Social Studies*
- PLS: ..... Profit and Loss Sharing*

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# **CHAPTER ONE**

## **INTRODUCTION**

This chapter contains general overview of the entire study. It includes the background of the study, definition of key terms, statement of the problem, research questions, objectives of the study, significance of the study, scope of the study, limitation of the study and organization of the study are presented in section.

### **1.1 . Background of the Study**

Islamic banking is now a well-known term and has emerged as one of the most important industries worldwide. Islamic banking is known for its interest free concept and operates in many countries including Bahrain, Pakistan, Jordan, Iran, Sudan, United Kingdom, Singapore and Malaysia. Islamic banking and finance has undergone rapid transformation and growth from an industry striving to satisfy the Muslim community needs, to a multibillion dollar industry upholding Islamic principles. Over recent decades the Islamic banking industry has emerged as one of the fastest growing industries and has spread to all corners of the globe, receiving wide acceptance from Muslims and non-Muslims (Iqbal and Molyneux, 2005).

A religion is an organized collection of beliefs, faith, cultural, system, ethics, morality and way of life. The first distinguishing feature of an Islamic bank must be that it is interest-free, while the abolition of Riba (which is any excess in financial dealings, usury or interest) because in the Holy Quran “God has permitted trade, but forbidden Riba (interest)” (2:275). Islam is a complete code of life that provide guidance regarding each aspect of life and the primary objectives of Islamic economic system are as under an equal distribution of wealth and social justice in that case this objective are not compatible with interest because when there is interest there is no justice. The origin of Islamic banking can be traced back when the prophet (pbuh) himself acted as an agent for his wife’s trading operation using many of the same principles uses in the contemporary Islamic banking, therefore the first attempt to establish Islamic bank was Mit-Ghamr IB in Egypt 1960’s. Pious landowners deposit their funds without interest reward and therefore credit was advanced to other poorer landowner for agricultural improvement (Abdillahi Bileh2016).

According to the “International Financial Law Review”, The Shariah developed four main Islamic juristic schools (Hanafi, Maliki, Shafi, Hanbali) and is derived from two primary

sources, The Quran (the transcription of God's message to the prophet Mohammed) and the Sunna (the living tradition of the prophet Mohammed). The prohibition of all sources of unjustified enrichment and the prohibition of dealing in transactions that contain excessive risk or speculation are among the most important teachings of Islam in establishing justice and eliminating exploitation in business transactions. Accordingly, Islamic scholars have deduced from Shariah three principles that form the benchmark of Islamic economics and distinguish Islamic finance from its conventional counterpart. The prohibition of interest (riba) is the most significant principle of Islamic finance. Riba translates literally from Arabic as an increase, growth or accretion. In Islam, lending money should not generate unjustified income.

As Shariah term, it refers to the premium that the borrower must pay to the lender along with the principal amount; as a condition for the loan or for an extension in its maturity, which today is commonly referred to as interest. Profit and loss sharing: Profit and loss sharing (PLS) financing is a form of partnership, where partners share profits and losses on the basis of their capital share and effort. Unlike conventional finance, there is no guaranteed rate of return. Islam supports the view that Muslims do not act as nominal creditors in any investment, but as partners in business. The justification for PLS financier's share in profit is their effort and the risk they carry, because their profit would have been impossible without the investment. If the investment makes a loss, their money is lost. Gharrar refer to any transaction that involves uncertainty and speculation. Parties to a contract must have knowledge of the subject matter of the contract and its implication and an example of an agreement tainted with gharrar is an agreement to sell goods that have already been lost. Islamic scholars have approved certain basic types of contracts as being compliant with the principles of Islamic finance, which Islamic banks can use to attract funds and provide financing in an Islamic way. Therefore these contract include: Mudaraba (finance by way of trust), Musharaka (finance by way of partnership), Murabaha (cost-plus financing), Ijara (leasing), Salam (advance purchase) and finally Istisna'a (commissioned manufacture).

## **1.2. Statement of the Problem**

Garas (2007) explores that Islamic financial institution facing two types of challenges i.e. internal and external. The internal challenge is to involve those customers who are using conventional banking product whereas external challenge is to fulfill the international transaction requirements due to lack of Islamic regulatory system. To penetrate in

international market and increase local potential customers the Shari'ah principles and implications of Islamic products analyze through collaborative research from Shari'ah scholars and researcher (El-Din *et al*, 2007). Whereas, Khan (1986) suggest that Islamic banking utilize the expertise of Shari'ah scholars to judge the Shari'ah compatible problems for financing local and international business.

According to Dusuki and Abdullah (2007), one of the major issue in development of Islamic banking and financial institutions in Malaysia is that the awareness of public towards Islamic financial industries is severely low. In order for the public to clearly understand the concept of Islamic banking and financial institutions, public educations and campaigns are required to be organized intensively. According to Fahmy and Yusof (2008), some Malaysians claim that Islamic banking is just a change in name of Conventional Banking as they argue that the interest rate under conventional banking is just converted to the profit rate in Islamic banking only. As refer to the research of Halim and Hamid (2001), the marketing effort provided by Islamic banking and financial institutions to their clients is still inefficient. Compared to conventional banks, Islamic banks involve only minimum effort to marketing their products and services.

According to Adebayo (2010), many Muslims are satisfied with the operation of the conventional interest-based banking system which is against the spirit of their religion. They are however incapacitated by the fear of exposing their money to risk of theft should they decide to keep their money at home, or the fact that their wages will be paid to them trough the bank, or rather, some other unavoidable transactions with these conventional banks which do not operate in line with the dictate of Allah. Those who opted for current account with these banks still stand the risk of moving in the periphery of unsurious transactions, as this product has percolated element of interest to customers as well.

According to the “world population review”, Djibouti is a small country with a total population of around 800,000. Main City is Djibouti, which accounts for more than 50% of the population of the country. As the city is small, majority of customers come to the city center for business as well as banking. Djibouti's economy is dominated by the tertiary sector through port activities and related logistics services, by banking and by telecommunication sectors which are experiencing strong growth. In that case Djibouti gain new investment and increase in term of business but also the country decouple its economic performance.

Islamic banking contains an important position in the financial sector of the Djibouti but it is necessary to look at the factors of its adoptability for its growth among both the Muslim and non-Muslim. Although its banking and financial rules are most in favor of conventional banking system due to the fact that Islamic banking is facing some difficulties in the way of its progress. In other words these problems are great challenges for Islamic banking. If banks authorities work harder, Islamic banking could be developed in a short span of time.

The need for Islamic banking services and the prohibitions of interest does not need any more justification as it just exists through the religious beliefs of Muslims. But it is worth looking at the reasons put forward by some for Islamic banking to assist with understanding and innovation. For example, Islamic banking will play a major role in the development of financial sector in a country like Djibouti, where there is a significant Muslim population.

To this regard, the researcher believed that there is a debate on the stakeholder's knowledge level on IFB, lack of governing principles and practices, and the level of understanding about its contributions to the economic development or resistant changes in Djibouti context. Based on the above problems, the current study is an attempt to assess the challenges and opportunities of Salaam African Bank.

### **1.3. Research Questions**

- How can an inadequate of staff training, challenge the growth of SAB?
- What is the level of awareness in the society regarding IB service?
- How effective are the supervisory and regulatory of SAB?
- Is there a lack of uniform standards among Islamic Banks?
- What is the actual potential demand for Islamic Banking?
- How well does the government support SAB?

### **1.4. Objectives of the Study**

#### **1.4.1. General Objective**

The general objective is to assess the challenges and opportunities of Islamic banking System operating in Djibouti especially at Salaam African Bank.

#### **1.4.2 Specific Objectives**

The specific objectives of the study are listed below:

- To assess the adequacy of staff training in SAB
- To identify the level of awareness in the society regarding IB service in Djibouti
- To assess the effectiveness of the supervisory and regulatory of SAB
- To explore if there is a lack of uniform standard among IB
- To explore the actual potential demand
- To assess the government support regarding SAB

### **1.5. Significance of the Study**

As a Muslim community it's more important to know what the Islam itself prohibited in term of transactions. Therefore the importance of this study is to know what challenge Islamic banking system can face and what kind of opportunity he might face. Moreover, This study will be very useful for other researcher and it can predict Islamic banks from challenges Furthermore Islamic bank doesn't include only the Muslim community it also include Non-Muslims people because they can also invest in these area, nowadays the IB sector is more profitable and can survive to crises rather than conventional bank.

More specifically, the study is expected to serve:

- As a supporting material for further study in the banking sector.
- As an inputs for Muslims and non-Muslims community,
- For Conventional bank to whether change their system or open an Islamic window in the existing system.
- To predict from the challenges of IB in Djibouti.

### **1.6. Delimitations of the Study**

From the entire financial sector that operated in IBS in Djibouti, there are only three that provide Islamic banking because other banks are operating with the conventional system. Therefore, the researcher conducted the study in one of the three Islamic banks who is known as Salaam African Bank in Djibouti, but in addition the study where done through a Questionnaire in a period of time of two months. Moreover, these study included society and staff that work inside Islamic banks and some selected manager. The study deals with challenges and opportunities with regard to the challenges one might think many challenges that affect IB operation. However, this study focus on issues like (Inadequate skilled staff,



Lack of awareness in the society, Supervisory and regulatory, Lack of uniform standard). With regard to the opportunities issue consider as (Current potential demand of Islamic, Expansion to capital market, Government support).

### **1.7. Organization of the Research**

The research is being organized into five chapters. The first chapter includes background of the study, statement of the problem, research question and objectives of the study, significance of the study, scope and limitations of the study. The second chapter is about related literature review and the third one is about general research methodology. The fourth chapter is focused on analysis of the subject matter to investigate and evaluate the problems. The final chapter is finalized by forwarding conclusion and recommendations on the study based on findings.

### **1.8. Operational Definition of the Key Terms**

The researcher would like to introduce some important key terms and concepts used in the context of this study for ease of understanding of the research report.

**Haram:** haram is used to refer to any act that is forbidden by God (al-ahkam al-khamsah)

**Shariah:** Shariah literally means a well-worn path to a water source, and Islamically, it is a term that is used to describe Islam as a complete way of life ( ibn Al-Qayyim).

**Riba (usury):**Riba include any unjustified increment in borrowing or lending money(Abdel-Rahman Yousri Ahmad)

**Mudaraba:**Mudaraba is a basic principal of profit and loss, where instead of lending money, the banker forms a partnership with the borrower (Kettel 2006).

**Musharaka:** Musharaka mean partnership, whereby the Islamic institution provides capital needed by the customer with the understanding that they both share profit and loss (Farkhod2009).

**Murabaha:** Murabaha is a contract of sale because the financial institution act as a middle man and purchases the good requested by the customer (Haqqe 1993)

**Ijara:** Ijarah is a contract under which a bank buys and leases out an asset or equipment required by its client for a rental fee (Hume 2004).

**Bai'salam:** This contract is normally used for financing agricultural production. 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 (Hassan 2004)

**Istisna'a:** Is a new concept in Islamic finance that offers future structuring possibilities for trading and financing (Farkhod2009).

## **CHAPTER TWO**

### **RELATED LITERATURE REVIEW**

This research has an importance to review how fast Islamic banking system grow and what kind of challenges and opportunities it face. In this chapter, the relevant literatures are collected from different secondary sources and it gives information about IB history and development, IB versus conventional bank, IB instruments, the challenges and opportunities of IB and finally the empirical review, research gap and the conceptual framework.

#### **2.1. Theoretical Literature**

##### **2.1.1. Development and Growth of Islamic Banking.**

According to Farkhod Kholbutayev (2009) First attempt to establish Islamic bank was carried out in Egypt not referring to the religious aspects and this implicit attempt was due to the political situation that was prevailing during that time, as state was against of any movements and principles that were more or less connected with Islam. In 1963 Egyptian economist Ahmed al-Nadjar tried to integrate Islamic banking principles in the form of savings. This activity was based on mutual participation of parties in cases of success and failure. This new implementation was till 1976, when 9 banks were operating with Islamic principles. These banks neither add on nor paid interest, specializing on direct investment into industrial organizations alone or along with other counterparts.

The profit, which was earned in the state of success, was shared with business partners. Thus it operated more like saving institution rather than a bank. Nazir Social Bank established in Egypt in 1971 was announced as the first commercial bank. Islamic Development bank was founded in 1974 by Organization of Islamic conference, with the priority to develop intergovernmental projects and stimulate the economies of member countries. IDB provides financial services and supports member countries in interact in mutually beneficial projects as saving institution. Operations of IDB are line with Shariah law principles. During that time in many Muslim populated countries there were ongoing political reforms, which in turn gave an opportunity for legal Islamic banking activity. Beginning with the Middle East, a lot of Islamic banks established. Faisal Islamic Bank of Egypt 1977, Faisal Islamic Bank in Sudan 1977, Dubai Islamic Bank 1975, Bahrain Islamic Bank 1979, Philippine Amanah Bank 1973 as the banks with strict regulation on Islamic Shariah law. In Malaysia Islamic banking was established in 1983. First as saving corporation, where savings for Hadj pilgrimage<sup>21</sup> were

kept, was set up In 1969 this organization was transformed into the Malaysian hajj pilgrims fund boardly known as Tabung Hadj.

The activity of this organization resembles to corporation, which invests funds with the strict guidance of Shariah law. Basically this organization stimulated the development of new industry. As an example, establishment of Bank Islam Malaysia Berhad, this offered full spectrum of Islamic financial services. This bank has more than 14 representative offices around the world. In 70's India started to implement Islamic financial services to support its social development programs. So far there are 5 major institutions. Islamic Banking system known as Islamic Financial House set up in Luxembourg in 1978 was bright example to Western World of the Islamic banks' activity. Currently Islamic has well established itself in developed countries and not only. As one of the factors which boosted Islamic banking was, besides its ethical and religious principals, oil wealth of Arab countries which accumulated huge financial capitals during oil price increase in 1973-1974. Arab countries had to solve this huge surplus of financial funds. Oil revenues enabled various institutions with certain activities ranging from social and economic perspective, to actively participate in economic, social, cultural development. Simultaneously, theoretical and practical research were undertaken in order to set up banking institution without interest. Thus, mainly due oil revenues majority of Islamic banks were set up.

### **2.1.2. Concept of Islamic and Conventional Banking**

Like interest-based commercial banks, Islamic Banks are also the guardian of people's money but with a disparity, that Islamic bank is sharing profit and loss with customer while conventional banks not. This superiority makes Islamic banking unique from conventional banking and gives some ownership rights to customers. Islamic banking and conventional banking are very much dissimilar from each other, as conventional banking has interest-based ideology. While Islamic banking interest free system and principles and distribution their profit and loss with customer and sometimes share their services with business intermediaries (Arif, 1993). The logic behind the ban of interest and significance of Islamic financial system has been discussed in much Islamic economic system. The principles of Islamic financial system is creating financial atmosphere between partners, intermediaries, lenders and borrowers (Yudistira, 2004).

Islamic system of finance is a system with the aim to accomplish the education of Holy Qur'an as contrasting to gathering utmost income on financial assets. Islamic financial system has certain Islamic principles, and these ethics are the major concerns of Islamic system of finance. Standards of Islamic Law are created by Shariah & all dealings of Islamic system of finance governed by Shariah and Fiqah. (Rogers 2003).

At a fundamental stage, an Islamic financial system can be illustrate as a "fair" & a "complimentary" arrangement where "fairness" is the major purpose, nevertheless it also restrict the "freedom" of the Islamic financial system contributors are free to enter in any type of business but this freedom of entering in contact doesn't mean to enter in such transactions which involves Riba and Gharar (Taylor 1995). Islamic Banks have a strong association with depositor and in the same time it has affiliation with businessmen. The funds of depositors are concerned in productive Islamic financing while conventional banking is a simple example of lending and borrowing of funds. These two banking systems have huge difference in authority configuration also. Islamic banks have to pursue a diverse set of regulations-those started by the Holy Qur'an, & meet up the viewpoint of Muslim culture by given that Islamically-adequate financing modes (Suleiman, 2001).

Islamic banks are similar to those of non-Islamic banks in that equally propose alike (financial) services to their customers & play an essential responsibility in the economic expansion of their civilizations. Some interest-based banks are analogous as Islamic banks as they deal in the same financial services, but in this case the conventional banking has to go after the rules of Islamic Shariah for their financial services so that all the products contribution to the customer must be according to Islamic law. For instance, according to Islamic Shariah exploitative contracts based on Riba (usury or interest) or in just contrates that involve risk or conjecture are in foreseeable. Islamic banks compared with non-Islamic banks seek a "just" and "equitable distribution of resources". Islamic Fiqah governs Islamic banking and it ensures that all operations of Islamic Banking are in the circle of Islamic Law and Shariah (Siddique, 1985).

#### **2.1.2.1. Interest (Riba): The Reality**

There are many religious scholars and economists who believe that interest is prohibited in Islam because of the fixed return and the fact that there is no physical effort involved in it. This theory is only limited to interest earned from banks and not other forms of income which are earned without making any physical assets. Not all Muslims agree, some are of the point

of view that such ban was due to the intention to prevent some pre-Islamic practices which resulted in the slavery of many people at that time, and that other form of interest is permissible and in accordance with Islamic belief (Kuran, 2001).

According to Kamran, R (no date), describes interest as 'rent of money'. Interest is expressed as percentage of the principal and the rate is dependent upon the time value of money, the credit risk of the borrower and the inflation rate. The interest is calculated upon the value of assets in the same way as money. Interest is compensation to the lender for the risk of not being paid back. Consider the borrower take assets from lenders and then enjoys the benefits of using those assets directly without making any efforts to obtain them, while the lender enjoys the fee paid by the borrower for the privilege. The principal value is held by the borrower on credit. Interest is, therefore the price of credit, not the price of money as it is commonly believed to be. According to Dr. Aqdas, A. Kazmi (2009), the concept very common throughout the Muslim world is the misinterpretation of the word RIBA mentioned in many Quranic verses, through which Shariah scholars have agreed upon and created so influential point of view that Riba, prohibited in Quran and the bank interest are identical and so interest should be abolished from all tiers of economy. There are a lot of Quranic verses found in the literature about Riba, but Muslim scholars never seriously discussed three basic questions.

1. What is Riba?
2. What is Interest?
3. Are Riba and Interest same and identical?

The word that is being used for interest is SOOD meaning 'black color'. Interestingly this word has no existence in Quran, Hadith or Sunnah with reference to interest; instead the word used there is RIBA in the Holy Quran. The simplest and common meaning of Riba is disproportionate profit. This mean that proportionate profit is allowed and disproportionate profit is forbidden. The question here arise that who will decide what is proportionate profit and what is disproportionate profit. The decision here is left merely to human beings, common man. It's true that everyone some-where in core of his heart has a fair idea of what is wrong and what is right. Let's see this by example: suppose a shopkeeper purchases a commodity of Rs 5 and sells it for Rs 15, he is earning disproportionate profit which is Riba as it means. On the other hand a shopkeeper is said to be earning a proportionate profit when he sells a commodity for Rs 15 having purchased it for Rs 12. When you deposit money in

Bank, suppose 100000Rs and the Bank informs you that you will receive 6% per annum profit, it means you will be getting 500 Rs every month, 6000 Rs in a year. If you are getting 500 Rs per month on depositing 100000Rs it is not disproportionate. But there is an ethical element which is present in this transaction that you would be spending your money all by yourself and you should not invest that money (500 Rs) somewhere else. It should be clear that Banks do not pay you interest from their own pocket by keeping your money with them. They invest that money in running businesses and make profit from it, out of which a nominal percentage is given back to you. Many religious Scholars have termed not only interest but also working in banks as forbidden (haram). This belief has influenced many people that they avoid doing job in banks and financial institutions even at very high salaries. They prefer to stay jobless as they consider being jobless far better than earning from such institutes which are supposedly working in such a way that is not permissible in Islam (Kamran, R no date)

### **2.1.3. Controversies and Challenges Involved in Islamic Banking**

#### **2.1.3.1. Challenges of Islamic Banking**

Islamic banking has been introduced in 1980 in Pakistan and from now it has achieved a tremendous growth and now there are many full fledged Islamic banks operating in Pakistan. It is expected that Islamic Banking will capture 12% of the deposit market by 2012(Sheik, 2007). As mentioned earlier Shariah is derived from fatwa, the Islamic financial and economic concepts which are not clearly understood from Qur'an and Sunnah are better clarified through Fatwa. As Islamic financial products have been developed in the light of the fatwa, therefore, Fatwa is very important in Islamic banking. According to (Ali, 2005), Fatwa is basically a religious ruling on matter of Islamic laws not clearly mentioned in Shariah. Fatwa is required on those matters, which are uncertain in Islamic banking activities and are not in line with Shariah. The main problem arises, as far as fatwa is concerned that at present there is no single authority that governs Islamic financial industry.

There is no harmony among the Shariah scholars who give ruling about Islamic financial products. All the Islamic banks have their own Shariah Supervisory Board (SSB) who has knowledge of both finance and religion. According to (Briault, 2007) the challenge facing Islamic bank is the diversity among the Shariah scholars, due to which lending consumers and investors are uncertain whether the particular practice or product, is Shariah compliant. Even common Muslims have unclear concept about the difference products offered by

Islamic banking. According to (Malik, et al, 2011), relating to the issue of fatwa, the other major concern for the Islamic banks is the interpretation of different Shariah rulings. This different interpretation is due to the fact that there are different sects in Islam and all sects have their own authority and bodies, which provide guidance and interpretation on Shariah issues. There is always a possibility that the interpretation on certain Shariah issues given by one sect committee or scholars is different from the interpretation of other sects, which makes things more complicated. For example, in Jordan a prominent Muslim scholar criticized the penalty imposed by the Islamic banks in case of client default in Murabaha and declares that it is a kind of Riba. Similarly, a famous British scholar advises against the Islamic mortgage due to the fixing of rent and profit percentage with interest rates (Asad, 2009).

According to (Patel, 2010), which clearly describes that Islamic banks are not completely Shariah compliant in true sense, while the Shariah committee of the banks mentioned in the annual report that all the affairs of the banking division is carried out in accordance with Shariah rules and principle. It is a matter of fact that Islamic banking system requires an independent and specific Islamic banks, and as there is nothing like half or 75% Islamic. There are certain bodies and regulatory authorities like IFSB (Islamic Financial Services Board) and AAOIFI (Accounting and Auditing Organization for Islamic Financial Institution), which are trying to resolve the issue of standardization (Ainely et al, 2007).

According to (SOLE, 2007), one of the main goals of this organization is to design and disseminate accounting and auditing standards that can be applied internationally by all Islamic institutions. However (Malik, et al, 2011), is of the point of view that without a consensus of religious experts, there cannot be any binding and universal set of Islamic banking rules. Another challenge faced by the Islamic banks is the shortage of skilled peoples both at operational level as well as there is shortage of Shariah scholars. The people working in conventional banks can easily understand the operation of Islamic banks but to develop an Islamic product one should know the Shariah rules and regulations.

### **2.1.3.2. Opportunities for Islamic Banking in India**

Mohammad Faisal (2013) Islamic banking industry has experienced fast development in the recent decades, rising demand and increasing popularity around the world. It is fast emerging as an alternative to the interest based conventional banking. In order to match with the pace of 19 the global economy, Indian policy makers can hardly afford to ignore the global potential of Islamic banking system. The adoption of Islamic banking is not just offering an



alternative system of banking to the customers; it is a step in the direction of integrating with the world market. The global financial crisis of 2007-09 has acted as a catalyst to redefine financial markets in favor of Islamic banking. In many emerging economies, Islamic banking institutions are leading the way to provide services to under banked populations previously ignored by conventional banks. To Muslim business (and non-Muslim business), Islamic banking is a viable alternative for their financial needs. Briefly the less the challenges the more the opportunities because the opportunities itself is a dependent variable with the challenges.

Besides major prohibitions of Islamic finance, there are still some major factors which have to be outlined regarding Islamic financial system. One of the main incentives of successful financial system is that it should be based on fairness and equality among agents. Mohammed Obaidullah in his work "Islamic financial services" outlines major financial system principals and refers to the research study Shefrin and Statman (1992). These major principals include freedom from coercion, freedom from misrepresentation, right to equal information, right to equal information processing power, freedom from impulse, right to trade at efficient prices, right to equal bargaining power. To add on, there Islamic norms of financial systems.

**Freedom from Price control and manipulation-** In Islam it is regarded unlawful to engage in price manipulation. Price determination should be free of interference and any attempts to artificially influence supply and demand is regarded as *ihthikhar*, which in turn is unethical.

**Entitlement to Transact at Fair Prices-** In some cases there is a difference between exercised and fair price, transactions carried out by the difference of these two prices are regarded as *ghubn* and is indeed unethical.

**Entitlement to Equal, Adequate and Accurate Information-** As part of a fair game, Islam prohibits the announcement of false information as well as harboring important information. This situation is termed as *ghish*, the presence of *ghish* makes a contract unethical according to Islam's teachings. Many Islamic scholars have consensus regarding the situation that all transactions should be clear of misrepresentation. Thus, in order to be a lawful transaction all information should be available to investors.

**Freedom from Darar (Detriment):** Refers to a situation when a third party may be adversely influenced by the contract between two parties. If a contract between two parties executed with their mutual consent is detrimental to the interests of a third party, then it may enjoy certain rights and options. A case in point is the pre-emptive right (*alshufa*) of a partner in joint ownership. (pp 27-28). So, Islamic financial system seeks purity and fairness in all transactions, anything that violates the ethics, will be regarded as un-Islamic. In the graph

given below we can see how Islamic financial system is organized using its own Shariah compliant products and services. As already mentioned that savings which result in the difference between income and savings, are transferred from surplus to deficit entities. In the case of financial intermediation, savings are funded in banks under available contracts (mudarabah, musharakah, ijarah, ijarah wa iqtina and etc) where in banks form partnership with investors and allocate resources in the most efficient way. Once funds are deposited Islamic banks in turn form a partnership with other deficit entities to finance business projects under lease and sale contracts. In the case of direct financing, Islamic bonds sukuks of all forms can be used extensively. Sukuks can be used to mobilize funds which are used in financing and investments. Depending on the nature of businesses transaction certain financing contracts and sukuks might utilized.

### **2.1.3.3. Benefits of Islamic Finance**

It is often argued that Islamic finance is inherently less prone to crisis because its risk-sharing feature reduces leverage and encourages better risk management on the part of both financial institutions and their customers. It is also argued that Islamic finance is more stable than conventional finance, because:

- Islamic finance involves prohibition against speculation
- Financing is asset-based and thus fully collateralized and
- It is founded on strong ethical precepts. Moreover, Islamic financial institutions (IFIs) are considered to be a good platform for increasing access to financial inclusion, including access to finance for SMEs, thereby supporting growth and economic development.

Islamic finance help promote macroeconomic and financial stability. The principles of risk-sharing and asset-based financing can help promote better risk management by both financial institutions and their customers, as well as discourage credit booms, Indeed, IB resembles the proposal made in the 1930s under the Chicago plan, which required full backing of bank loans, and which recent research has suggested would lower macroeconomic volatility and the risk of bank runs (Benes and Kumhof 2012; and Wolf 2014). The underlying ethical precepts of Islamic finance provide, in principle, an important basis for high levels of ethical conduct, governance, and consumer protection.

However, much of the potential of the industry remains to be exploited. The empirical evidence does not yet confirm that IB has promoted financial access and depth once structural factors are accounted for (Barajas, Ben Naceur, and Massara 2015). Moreover, there are questions about the extent to which financing by Islamic banks is truly risk-sharing or whether PSIAs are fully loss absorbing, suggesting that Islamic banks may be just as exposed to risks as conventional banks (Lopez-Mejia, Aljabrin, Awad, Norat, and Song 2014). In addition, true securitization of Sukuk underlying assets is the exception rather than the rule, and asset-backed transactions are often highly complex, layered transactions that are designed to avoid the appearance of paying interest—termed by some as “Sharia” arbitrage (El Gamal 2006).

#### **2.1.3.4. Consensus and ambiguities**

Although Islamic banking is becoming more prominent, the extent of academic literature on Islamic finance is still comparatively small (Beck et al., 2013). Previous research differs for instance in the precise research topic and in the choice of countries under study. A large body of literature compares Islamic and conventional banks on different aspects but there are also studies that focus on Islamic banks only. The focus lies for instance on differences in risk management practices (Rahman et al., 2015), business models (Beck et al., 2013), or compliance with international standards (Al-Hares et al., 2013). Many studies focus on the performance of conventional banks compared to Islamic banks (Jawadi et al., 2016; Johnes et al., 2014), differences in profitability of both bank types (Khediri et al., 2015), or how bank performance changes during financial recession (Siraj & Pillai, 2012).

However, the results are mixed: Jawadi et al. (2016) do not find any significant differences in the performance indicators of both bank types leading to the suggestion that Islamic banks are rather competitors for conventional banks than an alternative to the conventional banking system. Their sample comprises 20 banks from 16 countries, where Islamic banks are from Asia but conventional banks also include banks from European countries that are subject to different economic conditions. Khediri et al., (2015) however argue that Islamic banks are more profitable and both types of banks were affected by the global financial crisis but shifted in time which might have been evoked by the trading of tangible assets only and the prohibition of financial speculation in Islamic finance. In their research on six conventional and six Islamic banks, Siraj and Pillai (2012) find similar results and conclude that Islamic banks were less affected by the crisis than conventional banks. Johnes et al. (2014) were

looking at the efficiency of both bank types and found that Islamic banks are less efficient considering the method of banking, but more efficient in terms of managerial efficiency.

The differences that exist between Islamic and conventional banks are intensified or mitigated depending on the size of the banks and the country in which they are operating (Beck et al., 2013). The results of Rahman et al. (2015) indicate that conventional banks in Bangladesh make use of more advanced risk management techniques but other results suggest that Islamic banks are better at dealing with credit risk (Khediri et al., 2015; Samad, 2004). Previous research is partly focused on one country only, for instance Bahrain (Samad, 2004; Sarea, 2012) or Malaysia (Chong & Liu, 2009).

### **2.1.3.5. Islamic Finance**

Islamic finance refers to the provision of financial services in accordance with Islamic Jurisprudence (Sharia). Sharia bans interest (Riba), products with excessive uncertainty (Gharar), gambling (Maysir), short sales, as well as financing of prohibited activities that it considers harmful to society, it also requires parties to honor principles of fair treatment and the sanctity of contracts. Transactions must be underpinned by real economic activities, and there must be a sharing of risks in economic transactions.

Islamic finance products are contract-based and may be classified into three broad categories:

(Hussain, Shahmoradi, and Turk 2015):

- Debt-like financing structured as sales, which could be sales with mark up and deferred payments (Murabahah) or purchases with deferred delivery of the products (Salam for basic products and Istisna for manufactured products), and lease (Ijarah) with different options to buy. Pure lending is allowed only when benevolent (Qard, which is often used for current deposits).
- Profit-and-loss-sharing (PLS) like financing with two modalities: (i) profit-sharing and loss-bearing (Mudarabah) whereby the financier (investor, bank) provides capital and the beneficiary provides labor and skills (profits are shared, but losses would be borne by the financier who does not have the right to interfere in the management of the financed operation, unless negligence, misconduct, or breach of contract can be proven), (ii) pure profit-and loss-sharing (Musharakah) where the two parties have equity –like financing of the project and would share profits and losses; and

- Services, such as safe-keeping contracts (Wadi'ah) as for current deposits, or agency contracts (Wakalah), which are also increasingly used for money market transactions. Interest is a contractual instrument by which the lender collects predetermined interest added to the principle amount it has lent out. The principal amount can be money, gold, silver, or fungibles including wheat, barley, dates etc. (Qasaymeh 2011).

#### **2.1.3.6. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)**

AAOIFI was found in the state of Bahrain on 27th of March with the objectives to develop core standards in auditing, accounting, Shariah and in governance for Islamic institutions. Detailed comparison of balance sheets of conventional and Islamic banks is discussed below, but there are certain differences between them. The basic difference is in the principals of balance sheet where Islamic banks balance sheet are based on profit and loss sharing nature. This creates certain complications in assessing and evaluating the state of balance sheets. In order to overcome these existing problems AAOIFI seeks to resolve differences. AAOIFI objectives fully correspond to the Shariah. This is done to assure depositors regarding the ethical norms and to increase their confidence in Islamic financial institutions We can briefly summarized the main objectives of AAOIFI.

1. to develop accounting and auditing thoughts relevant to Islamic financial institutions;
2. to disseminate accounting and auditing thoughts relevant to Islamic financial institutions and its applications through training, seminars, publication of periodical newsletters, carrying out and commissioning of research and other means
3. to prepare, promulgate and interpret accounting and auditing standards for Islamic financial

#### **2.1.3.7. Shari'ah Advisory Boards/Committees**

All Islamic Financial Institutions are required to have a Shari'ah Supervisory Board/Committee. This Board should consist of trustworthy scholars who are highly qualified to issue fatwa (religious rulings) on financial transactions. In addition, Shari'ah board members ought to have considerable experience in modern business/financial dealings and transactions.

The world renowned Shari'ah expert, Sheikh Nizam Yaquby point out:

“The Article of Association, prospectuses, or statutes (depending on the type of activity) should provide for the existence of a Sharia advisory board, whose fatwa and resolutions should be binding upon the financial institutions board of directors and management. The advisory board is required to be independent and free to give opinions on proposed contracts and transactions. The role of Shari’ah supervisory board should be concurrent with that of the financial institution itself in the sense that it should be formed from the moment the financial institution is incorporated, and that should provide continued supervision and permanent checking of contracts, transactions and procedures. This should be expressly provided for in the Articles of Association or the prospectus.”

#### **2.1.4. Introduction of Islamic Banking Products**

Islamic banking products are increasing day by day and previous studies found that Islamic banking products are on a par with conventional banking products, according to Haidi and Malik (2006). There is a lot of Islamic banking products in Malaysia, however there are some common Islamic products that will be discussed briefly in this section.

##### **2.1.4.1 Investment Contract**

Investment contracts Mudarabah (fund management) and Musharakah (equity partnership) are mainstream contracts for capital investment. Mudarabah and Musharakah are more explain below:

**Mudarabah (trust financing)** According to Kettel (2006), *Mudharabah*'s basic principle of profit and loss, where instead of lending money at a fixed rate return the banker forms a partnership with the borrower, thereby sharing in a venture's profit and loss. *Mudharabah* is an agreement between the lender and entrepreneur, whereby the lender agrees to finance the project on a profit sharing basis according to a predetermined ratio agreed by both parties concerned. If there are any losses the lender will bear all the losses. It is one form of partnership in which one partner (*rab-ul-amal*) provides the capital required for a project; while the other party (*mudarib*) manages the investment using its expertise. The capital provider carries the loss in a *Mudharabah* contract unless it was due to the *mudarib*'s negligence or misconduct. *Mudharabah* may be conducted with the Islamic bank as the provider of funds on behalf of the depositors. The bank pays its depositors all profits from the investment after deducting its fees.

**Musharakah (partnership contract)** Musharakah means partnership whereby the Islamic institution provides the capital needed by the customer with the understanding that they both share the profit and loss according to a formula agreed before the business transaction is transacted. In Musharakah all partners are entitled to participate in the management of the investment but it is not compulsory. Musharakah provides financing for large investments in modern economic activities but is unfortunately not actively practiced in Malaysia. Moreover, all partners to a business undertaking contribute funds and have the right, but not the obligation, to exercise executive powers in that project, which is similar to a conventional partnership structure and the holding of voting stock in a limited company (Farkhod Kholbutayev 2009)

#### **2.1.4.2. Trading Contracts.**

These contracts can be categorized into two components. First type of contracts deals mainly with operational and financial leasing. Second component is more concerned with sale, Therefore they are well discussed below:

**Murabahah (mark-up)** Murabahah is a contract of sale. The financial institution acts as a middle man and purchases the goods requested by the customer. The bank will later sell the goods to the customer in a sale and purchase agreement, whereby the lender re-sales to the borrower at a higher price agreed on by both parties. These are more for short term financing. According to Tarek al-Diwany, *Murabahah* is a form of trust sale since the buyer must trust that the seller is disclosing true costs (Haque, 1993). The bank will later sell the goods to the customer in a sale and purchase an agreement, whereby the lender re-sales to the borrower at a higher price agreed on by both parties. Murabahah is derived from the root word which means profit, gain or a legal addition.

**Ijarah (leasing)** *Ijarah* is an Arabic term with origins in Islamic *fiqh*, meaning to give something on a rental basis. This is more in accordance with the *shariah* concept of leasing where the bank acquires ownership based on the promise and leases back to the client for a given period. The customer pays the rental but the ownership still remains with the bank or lender. As the ownership remains with the lessor (bank), who is responsible for its maintenance, it continues to give the service for which it was rented. Under this contract, the

lessor has the right to re-negotiate the quantum of the lease payment at every agreed interval to ensure rental remains in line with the market rates (Hume 2004).

**Istisna (Manufacturing contract)** *Istisna* is a new concept that offers future structuring possibilities for trading and finance. One party buys the goods and the other party undertakes to manufacture them according to agreed specifications. Normally, *Istisna* is used to finance construction and manufacturing projects.

**Bay'Salam** According to Farkhod Kholbutayev (2009) Bay'Salam is defined as the forward purchase of specified goods with full forward payment. This contract is normally used for financing agricultural production. According to Hassan (2004), Salam based future contracts for agricultural commodities, supported by Islamic banks, will offer to overcome the agricultural financial problem.

## **2.2. Empirical Review**

There are many studies undertaken relating to the attitude and perceptions of customers toward Islamic banking among that (Erol et al.1989); (Ahmad et al, 2002); (Ramdhony,2013);(Echchabi et al 2012);( Turnbull et al,1989); (Laroche et al 1986); (Zineldin, 1996) revealed that apart from religious feelings, other factors, such a perceived relative advantage, perceived trust, awareness, perceived compatibility, value group opinion influence, and facilitating conditions are important in choosing products and services in Islamic bank. While, ( Karim et al; 2004) indicated as Islamic banks are meant for Islamic consumers only, limited facilities provide compared to conventional banks, do not have a huge customers base and not sure of increasing popularity of Islamic banking products among non-Muslims.

In addition (Sharofiddin et al, 2013) investigated the challenges of conventional banking practices and prospects of introducing an Islamic bank in Tajikistan. The findings of the study show that relative advantage and awareness have a significant impact on the adoption of Islamic banking system in Tajikistan. Also, the other three independents variables such as self-efficacy (product knowledge), trust and social norm are insignificant relationship with the adoption of Islamic banking in Tajikistan.



(Ahmad et al,2002); ( Fada et al, 2012); (Gerrad et al 1997) studies perception towards Islamic banking and found that as knowledge of Islamic banking was limited , misconception of the subject matter and a general lack of awareness of the culture of Islamic banking in both Muslims and non-Muslims communities, the providers of Islamic banking products and services have not done enough in educating customer and marketing their products that resulting unpopularity of product and service among the customers. Similarly ( Malhotra et al, 2005) reported on his study customer “perception of service quality in developing countries as there is significantly different from the perception of bank customers in developed countries like the USA. Not only between countries that even if within countries the study conducted by ( Thambiah et al 2011) show that perception of urban banking customers in comparison with the rural customers seemed to vary in terms of perceived complexity, awareness, self-efficacy, Media influence and perceived trust.

To date, there have been very few studies conducted regarding the Islamic banking in Djibouti even if the majority communities are Muslims (96 percent). Djiboutians Muslims must be well aware about Islamic banking and offers huge opportunities to exploit that IB face the challenge of lack of awareness and understanding, legal, regulatory and institutional challenges; negative attitude of people towards IB ( wrong associations with religion), lack of trained human resource.

### **2.3Research Gap**

From the above empirical review most studies were emphasized on countries with large number of Muslims they didn't check on the reason why Muslims use conventional banks even if there is Islam bank in the country why do they take Riba (unsury), there is few research done on Djibouti Islamic banking moreover there is not a research done on “the assessment of the challenges and opportunities of IB in Djibouti”. The purpose of the study was to explore the behavior of customers towards interest free banking by using customer level of awareness , internal procedures the behavior of customers towards of the bank, what are the potential current actual demands and in general what in counter as a challenges and opportunities on IB in Djibouti. As well mainly to find out which variables mainly influences customers' adoption of interest-free financial product and services in the context of Djibouti.

## **CHAPTER THREE**

### **RESEARCH DESIGN AND METHODOLOGY**

The aim of this chapter is to highlight the design and overall methodological considerations of the paper. It outlines the general research approach which the paper follows and encompasses a discussion of the actual research design applied throughout the research. It also elaborates on the sampling method used and sampling size determined for the research. Finally, it constitutes the method of data collection and description of the data analysis method and ethical consideration of the research.

#### **3.1. Research Approach and Design**

##### **3.1.1. Research Approach**

In this study quantitative research approach method were adopted. The reason behind selecting the quantitative method is because the initial method was mixed research and because of the lack of cooperation with the in depth interview of the stakeholder, the result of the study changed to only a quantitative research. The intent of this study is to assess the Opportunities and Challenges of Islamic Banking in which the quantitative data collected will be helpful in the interpretation.

##### **3.1.2. Research Design**

This study was conducted using descriptive research design to show the challenges and opportunities of Islamic bank at Salaam Africa bank of Djibouti. A research design is the program that guides the researcher in the process of collecting, analyzing and interpreting the data. The researcher used descriptive research design because it involves gathering data that describes events and then organizes, tabulates, depicts and describes the data collection. The time horizon of this study is cross-sectional study as the data was collected at a single moment in time. Furthermore, the secondary data was based on others related literature materials such as electronic journal and articles.

#### **3.2. Population Sampling Size and Sample Techniques**

##### **3.2.1 Research Population**

The total number of Islamic bank operating in IBS are three and above them one was selected, the Salaam African Bank. Therefore the area of population for the research was customers of “Salaam African bank” which comprises of 150 customers on headquarter and of course samples was took in order to examine the response of these customers and in order to generalize to the entire population.

### **3.2.2 Sampling Techniques**

In selecting research subject sample, the researcher applied stratified random sampling technique in order to find representative sample. The reason to use stratified random sampling is that the categories of the strata are thought to be too distinct and too important to the research interest. In this study the researcher has selected customers of Salaam African bank and a stratified random sampling was used when selecting samples and distributing questionnaires to those sample respondents from the strata.

### **3.2.3. Sampling Size**

In order to determine the sampling size for this research a unique sampling size method was used because due to the time and the nature of the population. Therefore, the researcher set randomly by using sample determination formula developed by Taro Yemane (1967).

$$n = N / (1 + Ne^2)$$

Where:

n= the sample size

N= the population size

e= the level of precision (Sampling error)

$$n = 150 / (1 + 150 * (0.05)^2)$$

$$n = 111$$

### **3.3. Data Collection Instrument**

For accomplishing the research work and research objectives most of the data presented in this study was collected through primary sources via questionnaires from head office of SAB. The primary data was collected from the customers of SAB. Thus, in order to obtain the reliable and sufficient information, structured questionnaire were used as data collecting instruments. In addition to make the research more valid, credible and applicable secondary data were used for the issues raised in the research. For this purpose published sources, i.e. different books, web pages, journals articles and various project papers.

### **3.4 Reliability and Validity Test**

#### **3.4.1 Reliability**

The reliability of an instrument according to Saunders *et al.*, (2009) is the degree of consistency which measures attribute, in particular, whether or not it will produce consistent findings at different times and under different conditions, such as with different samples. Internal consistency involves correlating the responses to each question in the questionnaire

with those to other questions in the questionnaire. There are a variety of methods for calculating internal consistency, of which one of the most frequently used is Cronbach's alpha. Cronbach's alpha is a measure of internal consistency, that is, how closely related a set of items are as a group. It is considered to be a measure of scale reliability. Cronbach's alpha can be written as a function of the number of test items and the average inter-correlation among the items.

A commonly accepted rule of thumb according to Saleh (2009) for describing internal consistency using Cronbach's alpha is as follows.

0.9 -1.0 Excellent

0.8 -0.9 Good

0.7 -0.8 Acceptable

0.6 -0.7 Questionable

0.5 -0.6 Poor

0.0 -0.5 Unacceptable

Therefore, for this research the reliability is checked by the Cronbach's alpha reliability test it is found a Cronbach's alpha of 0.75 which indicates that there is high internal consistency. Therefore it can be said that the questionnaire is reliable and ready for distribution for population sample.

### **3.4.2 Validity**

According to Amin (2004), Validity defined as the accuracy and meaningfulness of the inferences by examining and questioning whether there are any other possible casual relationships and checked the unknown factors contributed to result and findings of the research. It is the ratio to which results obtained from the analysis of the data actually represents the phenomena under study. It contends that the validity of the questionnaire data depends on a crucial way the ability and willingness of the respondents to provide the information requested. The instruments selected can help to show the challenges and opportunities of Salaam Africa bank.

### **3.5. Methods of Data Analysis**

The data obtained from the questionnaire will be analyzed through the mean and the standard deviation. The data from the questionnaires is used to determine the challenges and opportunities of IB and it consist of five responses on liker's scale. These are 1.Strongly Disagree, 2 Disagree, 3 Neutral, 4Agree and 5 Strongly Agree.

### **3.6 Ethical Considerations**

All the research participants included in this study was appropriately informed about the purpose of the research and their willingness and permission was secured before the beginning of distributing questionnaire. Regarding the right to privacy of the respondents, the study maintained the confidentiality of the identity of each participant. A guarantee was given to the Salaam African Bank' respondents that their names should not be revealed in the questionnaire and research report. In order to ensure the success of the research, leaders were linked to subordinates in such a manner that each subordinate's response remains anonymous apart from being linked to a particular leader. Moreover, participants received a verbal and written description of the study, and informed consent was obtained before the survey. Participation in the study was voluntary, and all participant responses were confidential, all sources cited in this research are dully acknowledged.

## **CHAPTER FOUR**

### **DATA ANALYSIS AND INTERPRETATION**

This chapter deals with the collected data and interpretation. It has four parts, the first part is concerned with the questionnaire distributed and returned, the second part concerned with the background of the respondents, the third part concerned with challenges of IB and the final part concerned with the opportunities of IB.

#### **4.1 Questionnaire Distributed and Returned by Number and Percentage.**

Questionnaire Distributed		Questionnaire Responded		Question Unreturned	
Number	Percent	Number	Percent	Number	Percent
111	100	111	100	0	0

The Statistical Package for the Social Scientists (SPSS) Version 20 Software was used to process & analysis the data that were collected from 111 sample customers of Salaam African Bank. All the copies of the questionnaire were completed properly and returned. Accordingly, analysis and interpretation of data has been made in this part of the study based on 111 returned questionnaires.

#### **4.2. Demographic Characteristics of Respondents**

Description of the characteristics of the sample target population gives some basic information about the sample and their composition. This aspect of analysis deals with the personal data of respondents. The table below shows the details of background information of the respondents.

**Table 1: Demographic Characteristics of Respondent**

Item	Categories	Frequency	Percent
Gender	Male	77	69.4
	Female	34	30.6
	Total	111	100
Age	18-30	62	55.9
	31-40	33	29.7
	41-50	12	10.8
	51 and above	4	3.6
	Total	111	100
Educational level	Diploma	15	13.5
	Degree	60	54.1
	Master	34	30.6
	Phd	2	1.8
	Total	111	100
Work experience	0-5	52	46.8
	6-10	37	33.3
	11-20	17	15.3
	21 and above	5	4.6
	Total	111	100

Source: Survey Questionnaire Result (2018)

Table 1 above shows respondent's profile in this study. It depicts that 77(69.4%) of the respondents were male and 34(30.6%) of the respondents were female, therefore from the above information it's possible to conclude that the majority of the respondent were male. With regard with age, 62(55.9%) of the respondent age were 18-30 years, 33(29.7%) of the respondents were 31-40, 12(10.8%) were between the age of 41-50 and 4(3.6%) of the respondent were 51 year and above, Thus the majority of the respondents were aged between 18-30 years. In other side, 15 (13.5%) of respondents educational level was Diploma, 60 (54,1%) of the respondents were holding a degree, 34 (30.6%) of the respondents were master holders and 2 (1.8%) were phd holders, therefore the majority of the respondents were a Degree holders. Moreover 52 (46.8) of the respondents have a work experience of 0-5 years, 37 (33.3%) of the respondents were categorized under work experience of 6-10, 17

(15.3%) of the respondents were under a work experience of 11-20 and 5 (4.6%) under 21 years of work experience, Thus the majority of the respondents work experience were between 0-5 years. The participants of the study have various positions in their respective work are. The positions of the respondents were employees, accountants, professors, business man, job seeker.

### 4.3 Data Analysis and Interpretation

#### 4.3.1 Challenges of Islamic banking system

Under this sub-topic four challenges are presented hereby (The Inadequate skilled staff, Lack of Awareness, Supervisory and regulatory and the Lack of uniform standard) and are addressed with five options (strongly disagree, disagree, neutral, agree, and strongly agree).

**Table 2: Inadequate Skilled Staff**

Statements	Responses	Frequency	Percent%	Mean	Std. Deviation
Employees are not well familiar with Islamic banking principles and procedures	Strongly Disagree	11	9.9	3.5045	1.27831
	Disagree	17	15.3		
	Neutral	14	12.6		
	Agree	43	38.7		
	Strongly Agree	26	23.4		
	<b>Total</b>	111	100		
Non-trained bankers are restraining the provision of the Islamic banking services	Strongly Disagree	2	1.8	3.6036	1.01156
	Disagree	16	14.4		
	Neutral	27	24.3		
	Agree	45	40.5		
	Strongly Agree	21	18.9		
	<b>Total</b>	111	100		
Supervisors are not supporting by giving training to the bankers in order to meet customer's needs	Strongly Disagree	13	11.7	2.9820	1.24303
	Disagree	29	26.1		
	Neutral	34	30.6		
	Agree	17	15.3		
	Strongly Agree	18	16.3		
	<b>Total</b>	111	100		

Source: Survey Questionnaire Result (2018)



The rate of production is low when employees don't know enough to perform their jobs confidently. To save time, employers often delegate the task of training to employees who have been on the job longer. Your employees can contribute to the success of your company when they are trained to perform their jobs according to industry standards (Tina Amo 2018).

Having an inadequate skilled staff will reduce the productivity and profitability of your company. According to the table 2 the highest mean 3.6036 is scored from the statement two "Non-trained bankers are restraining the provision of the Islamic banking services" it's followed by the statement one "Employees are not well familiar with the Islamic bank principles and procedures" have a score mean of 3.5045 and the lowest mean return to the statement three "Supervisors are not supporting bankers to meet customer's need" have a mean of 2.9820. In general the grand mean of the inadequate skilled staff have a score of 3.3633 therefore the researcher conclude that the majority of the respondents agree that bankers are not well trained to know Islamic bank system and in that case this will restrain or be a challenge for IBS to growth but to be more precise supervisors or managers are responsible of providing training to their employees in order to enhance their productivity so if managers are not aware of a lack of training inside employees this will reduce the bank's profitability.

**Table 3: Lack of Awareness in the Society**

Statements	Responses	Frequency	Percent%	Mean	Std. Deviation
There is no significant difference between the Islamic and conventional banks.	Strongly Disagree	35	31.5	2.7117	1.43582
	Disagree	18	16.2		
	Neutral	13	11.7		
	Agree	34	30.6		
	Strongly Agree	11	9.9		
	<b>Total</b>	111	100		
The profit and loss sharing is the only principle representing the true spirit of IBS	Strongly Disagree	10	9	3.2252	1.18079
	Disagree	23	20.7		
	Neutral	24	21.6		
	Agree	40	36		
	Strongly Agree	14	12.6		
	<b>Total</b>	111	100		
Islamic banking is totally religious and has no any ethical concept.	Strongly Disagree	11	9.9	3.3333	1.32345
	Disagree	23	20.7		
	Neutral	23	20.7		
	Agree	26	23.4		
	Strongly Agree	28	25.2		
	<b>Total</b>	111	100		

Source: Survey Questionnaire Result (2018)

There is a lack of proper understanding of the true nature of Islamic banking among their depositors, client and even shareholders. The lack of education and unawareness creates ignorance and uncertainty in our choices. Islamic finance industry is facing the challenges of

ignorance about the Islamic banking system. People have different point of view about Islamic banking, some says Islamic bank is just like the conventional bank, where as few do not agree with the concept of Islamic banking and finance system (Muhammad Ayyub 2018). Therefore according to Table 3 the highest mean 3.33 return to the statement three “Islamic banking is totally religious and has no any ethical concept” then it’s followed by the second statement “The profit and loss sharing is the only principles representing the true spirit of the Islamic banking system”, with a mean of 3.22 and the first statement “There is no significant difference between the Islamic and conventional banks” have mean of 2.71. In general the researcher concludes that the societies are not well aware of the Islamic banking system because the profit and loss sharing is not the only principles of Shariah concerning the Islamic bank

**Table 4: Supervisory and Regulatory**

Statements	Responses	Frequen cy	Percent%	Mean	Std. Deviation
Islamic banking has an effective supervisory framework	Strongly Disagree	4	3.6	3.6486	1.49939
	Disagree	14	12.6		
	Neutral	29	26.1		
	Agree	44	39.6		
	Strongly Agree	20	18		
	<b>Total</b>	111	100		
Your bank fulfills all the requirements of the Shariah law	Strongly Disagree	8	7.2	3.8739	1.19177
	Disagree	7	6.3		
	Neutral	17	15.3		
	Agree	38	34.2		
	Strongly Agree	41	36.9		
	<b>Total</b>	111	100		
There are well-qualified managers that deal with the Islamic transaction.	Strongly Disagree	6	5.4	3.8468	1.09709
	Disagree	7	6.3		
	Neutral	19	17.1		
	Agree	45	40.5		
	Strongly Agree	34	30.6		
	<b>Total</b>	111	100		

Source: Survey Questionnaire Result (2018)

According to the “Financial Islam” Article, corporate governance is an essential ingredient for the development of a sound Islamic finance industry. It abides Islamic financial institutions with a set of Shari’ah compliance rules to govern their operations and transactions as well as to monitor and supervise the roles of all players within the banking system. According to Table 4 the highest mean 3.87 return to the statement two “Your bank fulfills all the requirement of Shari’ah” followed by the statement three with a score mean of 3.84 and the statement one have a score mean of 3.64. Therefore the researcher can conclude that the majority of the respondents agree that their bank have effective corporate governance that follow the Shari’ah and even they do have good managers that are well qualified and aware about Islamic banking transactions.

**Table 5: Lack of Uniform Standards of Credit Analysis**

Statements	Responses	Frequency	Percent %	Mean	Std. Deviation
There is an effective Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)	Strongly Disagree	2	1.8	3.9730	.89908
	Disagree	7	6.3		
	Neutral	13	11.7		
	Agree	59	53.2		
	Strongly Agree	30	27		
	<b>Total</b>	111	100		
Islamic banks in Djibouti has their own credit analysis	Strongly Disagree	1	.9	4.2703	3.89859
	Disagree	7	6.3		
	Neutral	18	16.2		
	Agree	59	53.2		
	Strongly Agree	26	23.4		
	<b>Total</b>	111	100		
There is a lack of experts that studies the financial feasibility, monitor the venture and evaluate the portfolio	Strongly Disagree	3	2.7	4.2883	5.55532
	Disagree	12	10.8		
	Neutral	32	28.8		
	Agree	42	37.8		
	Strongly Agree	21	18.9		
	<b>Total</b>	111	100		

Source: Survey Questionnaire Result (2018)

Lack of uniform standards of credit analysis: Islamic banks have no appropriate standard of credit analysis. Similarly, there is a widespread training need involving related aspects such as financial feasibility studies, monitoring of ventures, and portfolio evaluation. According to the Table 5 the highest score mean 4.28 return to the Statement three “There is a lack of experts that studies the financial feasibility, monitor the venture and evaluate the portfolio” followed by the statement two “Islamic banks in Djibouti has their own credit analysis” with a score mean of 4.27 and the statement one “with a score mean of 3.97 “There is an effective Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)”. Thus the researcher can conclude that Salaam Africa bank as well as other Islamic banks does not have the same way to analyze their credit and there is a lack of expert to studies Islamic financial transactions in that case to be very precise the Islamic banking industry cannot grow if there is no any AAOIF and expert to make every Islamic banks be the same in order to promote and expand more the Islamic industry.

### 4.3.2 Opportunities of Islamic Banking System

Under these variables there are seven statements with different section with five options (strongly disagree, disagree, neutral, agree, and strongly agree)

**Table 6: Current Potential Demand of Islamic Banking**

Statements	Responses	Frequency	Percent %	Mean	Std. Deviation
Banks are in a position to achieve their goals from Islamic banking window	Strongly Disagree	5	4.5	4.4054	4.95870
	Disagree	6	5.4		
	Neutral	16	14.4		
	Agree	46	41.4		
	Strongly Agree	38	34.2		
	<b>Total</b>	111	100		
Muslims population is moving toward Islamic banking system	Strongly Disagree	4	3.6	4.2072	3.04248
	Disagree	9	8.1		
	Neutral	14	12.6		
	Agree	46	41.4		
	Strongly Agree	38	34.2		
	<b>Total</b>	111	100		
There is a high potential demand of IB in Djibouti	Strongly Disagree	2	1.8	4.3243	3.83326
	Disagree	6	5.4		
	Neutral	25	22.5		
	Agree	37	33.3		
	Strongly Agree	41	36.9		
	<b>Total</b>	111	100		

Source: Survey Questionnaire Result (2018)

The modern Islamic banking is about only five decades old but has gained significant interest in almost all parts of the world. Today, Islamic banking has become one of the fastest growing segments of the international banking and capital markets. The spread has been more in the last ten years, especially after the global financial crisis of the previous decade, primarily because Islamic banks were found to be more stable and less susceptible to crisis

(Jamia Hamdard 2016). According to the Table 6 the highest score mean 4.40 return to the statement one “Banks are in a position to achieve their goals from Islamic banking window” followed by the statement three “There is a high potential demand of IB in Djibouti” score with a mean of 4.32 and the lowest score mean 4.20 return to the statement two “Muslims population is moving toward Islamic banking system”. Thus the researcher can conclude that most of the respondents agree that Banks are in a position to achieve their goals from Islamic banking window but that it’s not the case in term of a researcher conventional and Islamic bank cannot be mixed in order to promote Islamic it’s much better to open other Islamic banks rather than just maximizing Islamic windows.

**Table 7: Expansion to Capital Market**

Statements	Responses	Frequency	Percent%	Mean	Std. Deviation
The Islamic banks have a high market potential for resources mobilization	Strongly Disagree	2	1.8	3.7117	.88818
	Disagree	6	5.4		
	Neutral	34	30.6		
	Agree	49	44.1		
	Strongly Agree	20	18		
	<b>Total</b>	111	100		
The Islamic financial industry is growing nowadays by the new entrance of some other IB	Strongly Disagree	0	0	4.4505	4.81614
	Disagree	3	2.7		
	Neutral	28	25.2		
	Agree	45	40.5		
	Strongly Agree	35	31.5		
	<b>Total</b>	111	100		

Source: Survey Questionnaire Result (2018)

According to online article “Reuters” Islamic banks have been tremendously successful in the five decades since the first Shariah-compliant lenders were launched and are growing at a

faster rate than their conventional counterparts. Yet some in the industry question whether the non-bank Islamic finance sector is better suited to providing long-term, risk-based funding for infrastructure and real-economy projects that would fulfill the industry’s mandate to support the communities in which it operates. According to the Table 7 the highest score mean that the respondents agree is the statement two “The Islamic financial industry is growing nowadays by the new entrance of some other IB “with a mean of 4.45 followed by the first statement “The Islamic banks have a high market potential for resources mobilization” with a score mean of 3.71. As a researcher, Salaam Africa bank as well as the other Islamic bank does not have a high market potential for resources mobilization because they are not willing to diversify or make Islamic banking resources more flexible and suitable with their clients.

**Table 8: Government Support**

Statements	Responses	Frequency	Percent%	Mean	Std. Deviation
The government give support to the Islamic banks	Strongly Disagree	9	8.1	3.7297	1.27882
	Disagree	14	12.6		
	Neutral	13	11.7		
	Agree	37	33.3		
	Strongly Agree	38	34.2		
	<b>Total</b>	111	100		
The government gives privilege to the Islamic banks rather than conventional banks.	Strongly Disagree	14	12.6	3.2162	1.28915
	Disagree	19	17.1		
	Neutral	28	25.2		
	Agree	29	26.1		
	Strongly Agree	21	18.9		
	<b>Total</b>	111	100		

Source: Survey Questionnaire Result (2018)



The government support play a big important role for enhancing any business moreover Islamic bank must grant support from the government specially when the majority of Djibouti population are Muslim in that case, Islamic banks must be more advanced compared to conventional because the community are Muslims and they must be aware of not using interest. According to Table 9 the highest mean 3.72 return to the first statement “The government give support to the Islamic banks” followed by the second statement “The government gives privilege to the Islamic banks rather than conventional banks.” As a researcher, Djibouti’s government may support the Islamic bank but not enough; they even give more advantage to conventional bank that why people are mostly using conventional one rather than Islamic banks.

## **CHAPTER FIVE**

### **FINDINGS, CONCLUSION AND RECOMMENDATIONS**

The major objective of the study was assessing the challenges and opportunities of Islamic banking in the context of Salaam African bank. In this chapter, summary of the major findings, conclusions and recommendations are presented hereunder.

#### **5.1 Summary of Major Findings**

Based on collected data analysis, the following major findings were presented:

Researcher found that the growth of the Islamic banking itself is restrained by the employees, because they do not have any background or are not well familiar with the Islamic banking principles and procedure, Moreover corporate governance are not willing of giving some training to their employees whom lack experience before even hiring them.

There is no negative attitude of customers regarding IFB (wrong association with the religion) because Islamic bank is drawn only from the Quran and the Sunna of the prophet (pbuh), Moreover the researcher have found that customer are not well aware or informed by Islamic banking because they are confused of making the difference of IB and conventional bank and the ignore that the profit and loss sharing is the major principle but it's not the only principle representing the Islamic banking

Researcher found that there are a well-qualified managers and Salaam bank fulfill all the requirement of the Shariah and there is an effective supervisors so there is not negative attitude regarding the corporate governance of SAB because they meeting activities with the Shariah.

There is no negative attitude regarding the AAOIFI because according to my findings there is an effective AAOIFI to check-on and monitor the activities. However, every Islamic banks analyze differently by their own the credit, therefore they do not have a uniform standard for credit analysis and it's due to the highest challenge who is the lack of expert that studies the financial feasibility, monitor the venture and evaluate the portfolio of Islamic banks.

Researcher found that Islamic banks are in position to achieve their goals of growing from the Islamic window opened in the conventional banks because even if there are only three IB that operate in Djibouti, every conventional banks have their own Islamic window in that

case it will be easy for customer to shift to the Islamic window, Moreover investor are willing to open other new IB because nowadays it seems to be very profitable.

There is no negative attitude regarding the expansion of IB to the capital market because they have a high potential demand in that case they just need to diversify their activities and make them more flexible and suitable to attract their clients and investors too. However the majority of the respondents agreed that there is a some level of government support but not the enough even if the community are all Muslims but otherwise they do get support.

## **5.2 Conclusion**

Research conclusions are drawn based on the major findings that are derived from collected data analysis.

The researcher concludes that an inadequate skilled staff can challenge the growth of the bank because if employees are not well familiar with the IB principles and procedures these can restrain the productivity and client might shift to conventional bank. The level of awareness in the society is very crucial for the growth of IB therefore clients are not enough aware about the difference that exist between Islamic banking and conventional bank. The role of supervisory and regulatory is very important for the improvement of IB system in that case the research conclude that there were well qualified managers at Salaam African Bank and the bank was fulfilling the requirement of Shariah.

The application of different methodology will lead to the inconsistent rulings. Addition to that Karbhari, Naser and Shahin (2004) claimed that the difference in Islamic cultures and societies within different country causing the interpretation of Shariah principles goes inconsistent among each of the Muslim schools; therefore the Djibouti's Islamic banks didn't have the uniform standard. The inconformity towards the Shariah views and different methodologies make the concept of Islamic financial institutions become unclear.

The researcher conclude that in term of opportunity, SAB was gaining more and more clients due to the providing services i.e Ijara (leasing), Moreover respondents were demanding the expansion of IB to market.

### 5.3 Recommendations

This study examines the challenges and opportunities of Islamic banking specially the case of Salaam Africa bank. Based on the conclusion and the major findings the major challenges arises from the lack of experts and lack of awareness in the society, therefore these following recommendations forwarded focusing on the issues which may have managerial implications.

- Supervision of Islamic banks is equally important. At present, lack of effective prudential regulation is one of the weaknesses of the Islamic institutions. Hence, Shariah Supervisory Board has to making an effective supervision framework to manage all the financial institutions in Djibouti and get more opportunities. The roles of both the Shariah Advisory Boards and the Central banks need to be streamlined and strengthened. The regulatory bodies must oblige the banks to reveal crucial information to the investors and thereby increase the efficiency of financial markets.
- Special importance should be known to make sure that good training programs are working by the Islamic Banking Institutions. Islamic Banks should be asked to give proper training seminars to the team members so that they may work in a better way.
- It is necessary and very important for the growth of Interest free banking system to have a high number of users therefore having awareness inside the society is important, in that case Uluma must encourage people to use Islamic banking system in order to avoid unsury “Riba” by this it will increase the numbers of users.
- There should be a promotion of cooperation between the bank and other institutions engaged in IFB business such as Islamic banks, therefore they must promote their resources by making diversifications, and making cooperation between IFB and institutions engaged in IFB business such as the Insurance “Takalful” companies.
- Conventional and interest free banking system should be governed by a different set of regulations as they differ from one to another in many aspects such as risk structure, credit analysis.....etc.

## **5.4 Limitations of the study and Implications to Further Research**

It is quite known that any study is not absolutely free from limitations. As a result, this study was conducted with some sort of limitations. The researcher was faced with many problems which, in fact, may affect the quality of the study:

- Limited collaboration from different stakeholders to fully cooperate for the in depth interview.
- Lack of related literature in the Djibouti context and reference book.

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**APPENDIX**  
**Questionnaire**  
**St.Mary's University**  
**School of Graduate Studies**  
**MBA Program**

Dear Respondents,

This questionnaire is designed to collect data's on "The Challenges and opportunities of Islamic banking". This survey is conducted as a partial fulfillment of the award of a Master on Business Administration at St. Mary's University.

I kindly request your participation in this survey by filling up this questionnaire. I would also like to inform you that any of your responses will be maintained confidentially and will never be used for any purpose other than the study.

Zahra Ali

Email: bilanzahra@outlook.fr

77 64 37 24

**Thank you in advance for your cooperation.**

**Instructions**

- Do not write your name in any part of the questionnaire
- Your frank response is vital for the success of the study
- Please put a "✓" mark on your choices

**Part One- General Information**

1. Gender                      Male                       Female
  
2. Age                      : 18-30     31-40     41-50     51 and above
  
3. Educational level: Diploma  Degree  Master  PHD
  
4. Work experience:    0-5     6-10     11-20     21 and above
  
5. Your current position.....

**Part Two: Statement related to the opportunities and challenges of Islamic Banking System.**

<b>Challenges</b>	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
<b>1. Inadequate skilled staff</b>					
Employees are not well familiar with the Islamic bank principles and procedures					
Non-trained bankers are restraining the provision of the Islamic banking services					
Supervisory are not supporting by giving the training to the bankers to satisfy customer needs					
<b>2.Lack of awareness in the society</b>					
There is no significant difference between the services of Islamic banks and conventional banks.					
The profit and loss sharing is the only principle representing the true spirit of the Islamic Banking system.					
Islamic Banking is totally religious and It has no any ethical concept.					
<b>3.Supervisory and regulatory</b>					
Interest free banking has effective supervisory framework					
Your bank fulfills all the requirements of Shariah law.					
<b>4.Lack of uniform standards of credit analysis</b>					
There is an effective Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)					
Islamic banks in Djibouti has their own credit analysis					
There is a lack of experts that studies the financial feasibility, monitor the venture and evaluate the portfolio					

<b>Opportunities</b>	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
<b>1. Current potential demand of Islamic banking</b>					
Banks are in a position to achieve their goals from Islamic banking window.					
Muslims population is moving toward Islamic Banking system					
<b>2. Expansion to capital market</b>					
The Islamic banks have a high market potential for resources mobilizations					
The Islamic financial industry is growing nowadays by the new entrance of some other Islamic bank					
<b>3. Government support</b>					
The government give support to the Islamic banks					
The government gives privilege to the Islamic banks rather than conventional banks.					