



**St.Mary's University**

**SCHOOL OF GRADUATE STUDIES**

**CHALLENGES AND PROSPECTS OF INTERST FREE BANKING, THE  
CASE OF COMMERCIAL BANK OF ETHIOPIA**

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*A THESIS SUBMITTED TO St. MARRY'S UNIVERSITY, SCHOOL OF GRADUATE  
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OF MASTERS OF BUSINESS ADMINISTRATION*

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**Jul, 2021**  
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This is to **certify** Ato Solomon Yimer that he has done a research on the topic **Challenges and Prospects of Interest Free Banking, the case of Commercial Bank of Ethiopia**. This research is of his original work and all the sources of material used for the study had been duly acknowledged.

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

I, Solomon Yimer, declare that this thesis is my original work, that complies with the regulation of the university, fulfill the accepted standard of thesis quality and all the material resources I use during the thesis had been duly acknowledged.

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## Acronyms

ATM = Automated teller machine

BBA= BAI Bithman Ajil

CBE= Commercial Bank of Ethiopia

IBS= Islamic Banking Service

IFB = Interest Free Banking

IFB= Interest Free Banking

IFI=Islamic Financial Institution

IS = Islamic Banking

NBE= National Bank of Ethiopia

R&D = research and Development

## **Abstract**

*This study examines challenges and prospect of Interest free banking services in Ethiopia with particular reference to the commercial bank of Ethiopia East Addis District. The study has employed descriptive research based on survey. Of the total sample interest free banking customers and staffs of the bank constitutes 355 and 60 respectively. The data was analyzed using descriptive statistics of mean, frequency and percentage using SPSS version 26 software. The study focuses that awareness, manpower, legal framework, social belief, resource needs as a number of the challenges whereas economic process, attraction of investors, and fostering investment square measure the probably prospects of the banks. 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. To attain the objectives of the study respondents were drawn through multistage sampling were applied. The study concludes that Islamic banking service can bring extra capability within the economy in reference to extra resource for banks, investment chance, reaching unbanked customers and employment opportunities within the country through effective mobilization. supported the higher than conclusions it's suggested that banks ought to produce awareness for public acceptance and coaching of staffs, use sensible selling techniques, governance ought to establish clear set of legal framework, and compliance with sharia law problems ought to be adhered. 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 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 word**

***Interst Free Banking, challenge, prospect, Islamic Banking***

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## CHAPTER ONE

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*This chapter shows the overall map of the study. It contented with background of the study, of the organization, statement of the problem, research questions, objective of the study, significance of the study, scope of the study, and eventually organization of the study.*

---

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

Banking in general has been considered an important financial intermediary and vital institution in the economic structure of any country. For a long time by mobilizing savings and idle funds in an economy and making them available to those who can make a better and fuller utilization of the same (Uzair, 1976). Recently, Islamic banking, has been seen as an alternative to conventional banking rather than one component of financial system. Since its 1960s beginning it has expanded worldwide with an excessive speed and its development has remained dynamic (Okumus & Genc, 2013). Operations in Islamic banking are governed by the Islamic principles known as Shariah. These principles come from the sources of the Holy Quran, Hadith, Sunna, Ijma, Qiyas and Ijtihad (Gait & Worthington, 2008).

The underlying idea of the above sources with regards to banking activities is the prohibition of interest. In other words, according to Kabir (1999), Okumus and Genc (2013), one of the most important doctrines that must be adhered by the banks is the prohibition of interest, which is Riba. Riba is defined as predetermined payment or any interest above or over the actual amount of the principal causes to unequal distribution of wealth in the society. Besides, Islamic principles demand that profits, risks and losses must be shared fairly between the transaction parties. This tenet or doctrine basically implies to the fact that transactions involving uncertainty and speculation (Gharar) are also prohibited. According to Islamic principles the businesses associated in the sectors such as alcohol, pornography and gambling are one of the other restrictions that must be adhered by banks operating in compliance with Shariah. Those are the tenets that the modern Islamic banking has been built on today. As such, an Islamic bank is a financial institution which operates with the objective to implement and materialize the economic and financial principles of Islam in the banking arena.

Currently, Islamic banking is widely practiced across the globe, mainly to accommodate and serve the interest of Muslim communities, and others who wish to use this service as witnessed by a number of countries having moved toward the transformation of their economic systems and banking sectors to accord more closely with the precepts and conditions of Islam (Khan, 1986).

Ethiopia has also taken a similar measure and it has introduced a directive in 2011, which is called the licensing and supervision of banking business (Directives to Authorize the Business of Interest Free Banking), which is briefly known as Directives Number SBB/51/2011 of the National Bank of Ethiopia ( NBE, Directives Number SBB/51/2011). This directive asserts that there has been increasingly strong public demand for interest free banking products in Ethiopia; and it mandates banks operating in the country to introduce and deliver Islamic banking/interest free banking services. Ever since several banks in the country have been offering this service to their clients.Commercial bank of Ethiopia is one of the pioneers to introduce this service to its clients. However, not much is known about the ongoing Islamic banking practices in Ethiopia as the field is infant and young. Issues such as challenges and prospects of Islamic banking at business or sectoral level in Ethiopia is not well explored. So, this study aspires to look into this contemporary phenomenon. The purpose of this study is to investigate the challenges and prospects of Islamic banking practices of Commercial Bank of Ethiopia (CBE).

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

In this modern day business world, both Islamic and non-Islamic countries are adopting practices of Islamic banking to their banking regulations to help spur growth (Imam &Kpodar, 2016). There is a vast literature on regulatory, monetary and institutional aspects of traditional/conventional banking system. This is not true for the interest-free banking practice (Zangeneh& Salam, 1993). Islamic Banking comes to Ethiopia very recently. The country's national Bank (NBE) even authorized Islamic banking service in the recent past in 2011 effective from 1st day of October 2011 (NBE, Directive No. SBB/ 51/2011). So, the goal of this research is to examine the challenges and prospects of interest-free in Ethiopia taking the case of Commercial Bank Ethiopia in order to shed light on the challenges and prospects encountered and this fill the theoretical and empirical gap as there is a dearth of study on the challenges and prospects of Islamic banking from this part of the developing world and have introduced Islamic

banking recently. Commercial Bank of Ethiopia is selected because it is the largest Bank in the country and is one of the pioneers to introduce Islamic banking service to its clients.

Further, as indicated above since interest-free banking is a very recent phenomenon in the country, there is lack of studies on the practices of Islamic banking and particularly in exploring the challenges and prospects. Perhaps, a related study was conducted in United Bank and Oromia International Bank by Akmel (2015), were prematurely involved in the study. However, United Bank introduced Islamic banking only in May 1<sup>st</sup>2014. This means Akmel did his study (2015) just a few months after United Bank has launched its interest-free banking service. This really sounds a pre-mature evaluation. Both Oromia International Bank and Commercial Bank of Ethiopia launched Islamic banking in early 2014 (December, 2013), and that means it is only just in a one year time or so, that Akmel conducted his study. So, this indicates an existing gap which relates to wrong timing. Moreover, the findings of Akmel are also generalized for the three banks he studied, and it lacks specificity. Besides, his study did not inform the specific challenges and prospects to the specific banks. That means the finding was gross. This indicates that there exists a research gap.

In addition other research in Ethiopia 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.

To fill the gap, As stated earlier the goal of this research is to examine the challenges and prospects of Islamic banking in Ethiopia in the case of Commercial Bank Ethiopia specifically in the eastern District in order to shed light on the challenges and prospects encountered and this will help close existing gap.

### **1.3. Research Questions**

To meet the stated objectives; the study tried to address the following research questions:-

- 1) What are the Islamic banking practices does CBE provide to clients?
- 2) What are the major challenges that have been experienced so far in rendering the Islamic banking service by the bank?

- 3) What are the prospects that have been observed in the Islamic banking service of the bank?

## **1.4. Research Objective**

### **1.4.1. General Objective**

The objective of this study is to assess the challenges and prospects of Islamic banking practices of Commercial Bank of Ethiopia.

### **1.4.2. Specific Objectives**

The specific objectives are to:

- 1) To identify the types of Islamic banking practices that Commercial Bank of Ethiopia provides to clients.
- 2) To investigate the challenges that the Commercial Bank of Ethiopia faces in rendering its Islamic banking services.
- 3) To point out the prospects that are associated with the Islamic banking services of the Commercial Bank of Ethiopia.

## **1.5. Methodology**

The research was designed in a quantitative approach. So, it was predominantly quantitative to generate numerical data for each variable. The respondents were drawn from bank clients and employees of Eastern District of CBE. Before determining the sample size of clients and employees, the research determined the sample size for branches. So, that means sampling was done at least at three stages: branch, clients, and employees of Eastern District in Addis Ababa. Then using convenience sampling approach questionnaires were distributed to readily available branches and respondents and this was deliberate sampling, which is one of the widely used sampling techniques in research. According to Kothari (2004) "deliberate sampling is also known as purposive or non-probability sampling.

## **1.6. Delimitation/Scope of the Study**

This study attempted to explore the challenges and prospects of Islamic banking in one of the promising sectors of the country the banking sector. More specifically, the Eastern District of CBE was studied. The bank is so vast, and for time and cost reason, the scope of this study was limited to one district Eastern Addis Ababa District. As CBE is vast it is very difficult to



study Islamic banking practice at corporate level. Hence, since Islamic banking is a homogeneous service across the bank's districts, the study focused on Eastern District of CBE for convenience purpose because the researcher had more established contacts in Eastern District.

### **1.7. Limitations of the Study**

The study focused on examining the Islamic banking service of CBE (Eastern District). It is worth to note here that since CBE is a very large organization, one district itself is a vast operation. For example, eastern District alone has over 70 branches. As researcher tried to justify this, this approach is taken for convenience and effectiveness reason. Ironically, this limitation may represent an opportunity for other researchers to address the limitation by expanding and developing the study.

### **1.8. Significance of the Study**

The study was concerned with examining the challenges and prospects of Islamic banking in Commercial Bank of Ethiopia. The result of the study helps in the following ways:

- Managers or concerned bodies of CBE would get some ideas on the challenges of Islamic banking so as to improve the bank system.
- Law makers can get a clear insight into the existing challenges and prospects of Islamic banking. Hence, they might take appropriate measures concerning the issue based on the findings and recommendations of the study.
- It give awareness for different stake holders who work on Islamic banking. It would also help for different banks that have similar issues.
- Finally the study helps for further researchers who are interested in conducting researches in the issue of Islamic banking.

### **1.9. Organization of the Study**

This study was organized into five chapters. The first chapter contains the introduction part which consists of the background of the study, statement of the problem, objectives of the study, significance of the study, the delimitation of the study, limitation of the study and organization of the study. The second chapter contains review of related literatures pertinent to the research. The third chapter deals about research design and methodology. The fourth chapter is concerned with

the analysis and interpretation of data and and discussion on important issues. Finally, chapter five presents about summary, conclusions and recommendations of the study.

### **1.10. Operational Definition**

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(AbdelRahman 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

### REVIEW OF RELATED LITERATURE

#### 2.1.Introduction

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*This section provides a review of related literature in light of the objective and research questions of the study. For the purpose of reminding, the objective of the study is to investigate the challenges and prospects of Islamic banking practices of Commercial Bank of Ethiopia (CBE). So, the point is that in the literature review is aligned with the objective of the study in general and the research questions in particular; i.e. it demonstrates the major types of Islamic banking products, challenges of Islamic banking, and prospects of Islamic banking. But before this, the paper was begin with highlighting the overview of Islamic banking. So, the resecher put clear theoretical imprical reviews of related letrature and finally develop conceptual framework that map the research journey.*

---

#### 2.2. Theoretical Review

##### 2.2.1. Overview of Islamic Banking

The emergence of strong Islamic movements in recent years has generated a renewed interest in Islamic Economics, especially Islamic banking. Countries like Iran and Pakistan have instituted Islamic banking systems, while many other countries have established mixed systems which combine aspects of Western and Islamic banking practices (Yousefi, Abizadeh & McCormick, 1997).

Currently, it is stated that Islamic banking is an area that has mushroomed to become an increasingly substantial segment within the global financial market. It has been recognized as a viable and competitive form of financial intermediation, not only in Muslim countries but also outside the Muslim world, and offering a wide range of financial products and services (Dusuki, 2008). The industry that started on a modest scale since its start in the mid-1960s and 1970's has shown a rapid expansion and evolution over the past three decades. It is in fact one of the fastest

growing industries, having posted double-digit annual growth rates for almost 30 years (Iqbal and Molyneux, 2005; Okumus&Genc, 2013).

Besides, Dusuki (2008) stated that Islamic bank must not be solely profit oriented, rather it must aim at promoting Islamic norms and values as well as protecting the needs of Islamic society as a whole. This model places greater social welfare responsibilities and religious commitments upon Islamic banks in order to achieve the Islamic economic objectives, including social justice, equitable distribution of income and wealth and promoting economic development. Further, Akmel (2015) stated that many scholars give various meaning to this term Islamic banking. It refers to a system of banking or banking activity that is consistent with the principles of the Shari'ah (Islamic rulings) and its practical application through the development of Islamic economics. The principles which emphasize moral and ethical values in all dealings have wide universal appeal. Shari'ah prohibits the payment or acceptance of interest charges for the lending and accepting of money, as well as carrying out trade and other activities that provide goods or services considered contrary to its principles. While these principles were used as the basis for a flourishing economy in earlier times, it is only in the late 20th century that a number of Islamic banks were formed to provide an alternative basis to Muslims although Islamic banking is not restricted to Muslims. This paper sticks to the definition of Islamic banking that was provided in the introduction part, where it was stated that Islamic banking, which is also known as interest free banking, are governed by the Islamic principles known as Shariah. These principles come from the sources of the Holy Quran, Hadith, Sunna, Ijma, Qiyas and Ijtihad and these principles fundamentally prohibit interest or riba (Gait & Worthington, 2008). This is also asserted by Bello and Abubakar (2014) that the definitions of Islamic banking revolved around one thing - Islamic law (Sharia's), and it is viewed and understood as a banking system which is run in accordance with the Islamic laws and principles. In other words, "Islamic banking is interest free banking, in which there is no fixed rate of return. Islamic banking is the banking system which is run in accordance with the Islamic laws and the Shari` board that guides the institutions" (Akram, Rafique, & Alam, 2011).

### **2.2.2. Islamic banking vs Conventional Banking**

There are fundamental differences between Islamic banks and their conventional counterparts, not only in the ways they practice their business, as argued by the advocates of Islamic banking, but above all in the values which guide the Islamic banks' whole operation and

outlook; and Islamic banking is concerned with much more than just refraining from charging interest. It is a system that aims at making a positive contribution to the fulfilment of the socioeconomic objectives of Islamic society inscribed in Maqasid as- Shari`ah (the objectives of Shari`ah) (Ahmad, 2002; Erol, 1990; Dusuki, 2008a).

In connection, in making comparison between Islamic banking and conventional banking, Samad (2004) mentioned that Islamic banks are non-conventional financial institution. Interest, the cornerstone of conventional banks, is completely prohibited under Islamic banking. Second, Islamic banks operate under dual constraints. While operating as a commercial bank, Islamic banks follow not only conventional business laws of the land, but also the Islamic principles Slaws. They have to sacrifice many profitable investment opportunities because those are not permitted under the divine laws of Islam. The next section provides a description showing the difference between Islamic banking and conventional banking practices.

The table below shows the difference between Islamic banking and conventional banking.

**Table 2.1: The difference between Islamic banking and conventional banking**

<b>Islamic Banking</b>	<b>Conventional Banking</b>
Functions and operations are guided by sources of Shariah (Islamic Divine Law) namely the Quran and the Sunnah (traditions of the Prophet Muhammad)	Functions and operations are guided by secular principles and not based on any religious doctrines and values
Institutions that aim at balancing between profit-maximization doctrine and social responsibility	Institutions that emphasis on profits Maximization
Financing instruments are based on either asset-backed trading contract or equity financing with risk sharing	Financing instruments are based on interest-bearing mechanism
Deposits are not interest-oriented but profit-loss sharing oriented whereby investors' principal repayment is not guaranteed but entitled to a predetermined share of actual profit realized by the business	Deposits are interest oriented and the investor is assured of a pre-determined rate of interest with a guaranteed principal repayment
No penalty on defaulters. However, some Muslim countries allow charging a small percentage of late payment penalty as a deterrent but the amount need to be channeled to charity and not treated as part of business income	Normally charge compounded rate of interest in case of default
Islamic banks are prohibited from participating in economic activities which are unethical and prohibited by Shariah such as businesses involving alcohol, prostitution, pork and environmental pollution, etc.	There are no such restrictions for conventional Banks

Islamic banks need to do charity by paying zakah (compulsory religious levy) out of their income	There are no such requirements to do charity
--	--

*Comparison of Islamic Banking and Conventional Banking ( Source – Dusuki, 2008b)*

Thus, as the above table indicates there are several differences between conventional banking and islamic banking. The most important difference is that, while functions and operations of conventional banking are guided by secular principles, for the most part, Islamic banking is operated based on religious doctrines and values. Another difference is that in conventional banking, institutions that emphasis on profits maximization, but in Islamic banking, the focus is balancing between profit-maximization doctrine and social responsibility

### **2.2.3. Principles of Islamic Banking**

According to the *Shariah*, Islamic financial institutions must be based strictly on four basic principles (Samad, 2004): Riba, Gharar, Zakat, and Ethical Investment

- i. All transactions must be interest free, i.e., free from *riba*.
- ii. Activities or transactions involving speculation (*gharar*) must be avoided.
- iii. The implementation of *zakat*, the compulsory Islamic tax.

No involvement in the production or consumption of goods and services which are *úaram*(i.e., illegal from the Islamic point of view).

The following is a discussion of these four principles provided by Samad (2004) that make the Islamic banking unique.

#### **2.2.3.1. Riba**

The *Qur'an* explicitly prohibits *riba* but does permit trade (*al-Qur'an,2: 185*). It does not clearly mention whether *riba* is interest or usury. The lack of clarity led to a controversy among the Muslim scholars in the past. However, there now seems to be a general consensus that the term *riba* includes any amount charged over and above the principal. The payment of interest or receiving of interest, which is the fundamental principle of conventional banking and financing, is explicitly prohibited in Islamic banking and finance. Thus, the prohibition of interest, in payment or receipt, is the nucleus of Islamic banking and its financial instruments, while the charging of interest in all modes of transaction whether it is in loan, advances or leasing is the core in the conventional banking. The Islamic banking is not simply interest-free banking. It takes into account issues of *gharar*, *úaram*, *zakat* and *qarè al-úasan* (Bala et. Al, (2009: 26).

### **2.2.3.2. Gharar**

Gharar is speculation or gambling and is forbidden in Islam. Islam allows risk-taking in business transactions, but it prohibits speculative activity and gambling. Any transaction involving the element of speculation like buying shares at a low price and selling them at a higher price in the future is considered illegal. Conventional banks, on the other hand, have no constraint in financing investment involving speculation.

### **2.2.3.3. Zakat**

Zakat is a compulsory religious payment or tax on the wealth of the rich payable to the poor. It is a built-in mechanism in Islam for ensuring the redistribution of wealth and the protection of a fair standard of living for the poor. Zakat is one of the five pillars of Islam. Each Islamic bank must establish a zakat fund and pay zakat on the profits earned. The payment of zakat is in addition to any conventional tax imposed (if the government is non-Islamic). Thus, the Islamic bank pays 'dual' taxes – zakat and corporate business tax. The interest-based conventional banks, on the other hand, are subjected to only corporate business tax, and thus have special advantage over the Islamic bank (Bala et.al, 2009 pp 30).

### **2.2.3.4. Islamic ethics of investment**

In Islam, investment in production and consumption is guided by strict ethical codes. Muslims are not permitted to invest in production, distribution and consumption enterprises involved in alcohol, pork, gambling, illegal drugs, etc., even though these enterprises may be profitable. Providing financing for such activities is illegal in Islam. Hence, it is forbidden for an Islamic bank to finance activities or items that are not permitted by the Shariah. The limitation of investment and financing is extended to cover any activity or business which may be harmful to the individual or the society. Thus, financing investment for the production or consumption of tobacco, alcohol or pornography is also prohibited. This restriction provides limitation on the profitability of the Islamic banks. On the other hand, conventional banks do not face any such constraint in their financing investments.

Similarly, Bello &Abubakar (2014) provided an interesting explanation of the basic principles or features of Islamic banking. They mentioned that Islamic banking is a unique type of banking system that devoid all forms of transactions that are prohibited in Islam. So, for any

bank to be classified as Islamic bank, the following basic principles must be adopted for its operations:

- a) Prohibition of interest (Riba). Interest means a fixed predetermined amount in addition to the principal. It is prohibited in Islam. So, for any bank to be called Islamic bank, it must not engage in any interest related transactions, but rather, profit and loss sharing transactions.
- b) Prohibition of speculation (gharar). The term gharar literally means hazard. More so, it means transactions that have too much risk and are therefore linked to gambling. Since Islam prohibits speculation, a potential Islamic bank will avoid all transactions with excessive risk.
- c) Profit, loss, and risk sharing. Since interest is prohibited in Islam, the providers of funds and the entrepreneur in an Islamic banking setting share the business risk and profits based on mutual agreement. This act will equitably distribute income, enhance social justice, and alleviate poverty etc.
- d) Shari'ah approved activities. Islamic banking is a banking system that is based on Shari'ah. So, any transactions that are prohibited by Shari'ah in the likes of alcohol, gambling etc. are avoided in Islamic banking. Islamic banks can only participate in transactions or activities that are approved by the Shari'ah advisors.
- e) Social Justice. Islam prohibits Muslims from any transactions leading to injustice and exploitation of any kind. So Islamic banks can not engage in any transactions that will lead to exploitation of any party.
- f) Compulsory payment of zakat. It is mandatory for an Islamic bank to pay zakat. Zakat is one of the five pillars of Islam.
- g) Overseen by Shari'ah advisors. Every Islamic bank must be regulated by experts in Islamic law who will have to audit the operations of Islamic banks and its products to make sure that they comply with sharia guidelines.

Further, Sole (2007) stated that besides the well-known Quran admonishment against *riba*(interest), *ghararandmaisir*(contractual uncertainty and gambling), and *haram* industries (prohibited industries such as those related to pork products, pornography, or alcoholic beverages), practitioners and supervisors must observe other principles to comply with Islamic prudence. Paramount among these are: compliance with the *Shariah*(Islamic law), segregation



of Islamic and conventional funds, accounting standards, and awareness campaigns. The following sections highlight the author's views on compliance with the *Shariah*(Islamic law), segregation of Islamic and conventional funds, accounting standards, and awareness campaigns.

### **2.2.3.5. Forms of Interest free/Islamic banking**

Bello and Abubakar (2014, p. 28) provided the following as modes of operation in Islamic banking. The authors stated that the modes of operation of Islamic banking are numerous and there is room for further innovation in the modes of operation provided they are in line with shari'ah's principles. They provided the following most popular modes of operations of Islamic banking

#### **2.2.3.5.1. Qard Hasan loans**

Qard Hasan loans is a benevolent loan given to deserving customers by Islamic banks to improve 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 (Bala et.al, 2009 pp 30).

#### **2.2.3.5.2. 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). That is, the Islamic bank will act as the capital provider (Rabb-ul-Maal). In this type of financial contract, profits are shared between Islamic bank and the entrepreneur (client) based on predetermined ratio. However, in the event of loss the Islamic bank (or depositors) bears the loss while the entrepreneur loses his or her effort provided it was not as a result of his or her negligence (Bala et.al, 2009 pp 25).

#### **2.2.3.5.3. Murabahah (Cost-Plus Sale Contract)**

This type of contract is mostly use in the procurement of equipment. It is a sale 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-plusmarkup which the client can either pay in installment or sum at a spot or at a stated period.

#### **2.2.3.5.4. Ijarah (Lease)**

Ijarah is synonymous to leasing contract in conventional banking. It is a contract whereby an Islamic bank purchases an asset and leases it out to its client on the agreement that the client will be paying a fixed amount at regular interval usually monthly for a specified period of time to the Islamic bank. It may also include the option of the client purchasing the asset at the end of the contract from the bank (Bala et.al, 2009 pp 31).

#### **2.2.3.5.5. Musharafa (Equity Partnership)**

Musharafa 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.

#### **2.2.3.5.6. Salam (Forward Trade Contract)**

This is a sale contract whereby Islamic bank agrees to supply some specific commodities to the buyer (its client) at a future date that is specified in exchange of an advanced full spot payment to the bank. That is, the client pays the full amount and delivery of the commodity to the client is done in specific future date by the Islamic bank.

In addition, although it is similar it is worth to appreciate the viewpoints of other authors regarding the modes of operation of Islamic banking so that the review of literature on this issue will not be limited to the viewpoints of Bello &Abubakar (2014). So, other authors (Hussain, Shahmoradi, and Turk, 2015; Samad 2004) state that key element of Islamic banking is not only just the interest-free receipt and use of funds. One of the most important elements of Islamic banking or finance is the concept of profit- and loss-sharing. Based on the profit- and loss-sharing principles, there are various types of Islamic financial instruments available in the market. Some of the instruments are equity-like contracts and some of them are debt-like contracts Siddiqi, 1983; Ahmad, 1984; Iqbal and Mirakhor, 1987; Ahmad, 1987 (cited in Samad, 2004) identified Islamic banking products such as Musharakah (partnership) muàarabah (trust financing) are the equity-like products.

**Mudarabah (Silent Partnership)** - *Amudarabah* 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*). Mudharabah is one of the most well-known Islamic investments and its principles are widely adopted by Islamic banks. In Mudharabah's partnership 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 on agreed upon ratio.

**Qard Hasan 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 (Roy, 1991:434).

**Musharaqah (Equity Partnership)** – Musharaqah or partnership is a type of investment in which participating 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. In other words, *Musharaqah* is a contract in which two or more individuals contribute capital for the establishment of a business whereby each partner exercises a right to either involve in the administration of the business or not. However, partners may decide to be active or dormant 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.

**Ijarah (leasing)**- this form of investment is characterized by having an owner of an asset (lessor) such as movable or immovable properties (automobile or a 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 (Bala et.al (2009 pp32).

**Bai-salam or Salam** - this refers to 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.

**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.

**Wadiah** -this refers to safekeeping.

### **2.3. Islamic Banking Service Models**

According to Sole (2007), Sanusi (2011), and Audu and Mika'ilu, (2014) (cited in Akmel, 2015), there are three types of Islamic banking service models: Islamic banking window service, Subsidiary/branch Islamic banking service, and Full-fledged Islamic banking service.

#### **2.3.1. Islamic banking window service**

Accordingly, the first one is an Islamic banking window, which is simply a window with a conventional bank via which customer can conduct business utilizing only sharia compatible instruments. Islamic banking window as a business model in which conventional banks offer Islamic banking products and services from their existing branch network. In short, Islamic banking window refers to a situation whereby a conventional banking system provides some of the Islamic banking products or services. In other words, it can be seen as a banking system that meets up only the profit, loss, and risk sharing principle of Islamic banking for some of its products (Bala et al 2009 pp34).

#### **2.3.2. Subsidiary/branch Islamic banking service**

The second one is Subsidiary/branch Islamic banking service, which is characterized by a commercial banking unit, which offers sharia compliant products and services only in the specific branch. It is a semi-independent office of a bank engaging in banking activities such as accepting deposits or making loans at facilities away from a bank's home office. This branch banking established when the main bank feels there is a potential of concentrated customers that are found in the area want to serve these customers.

### **2.3.3. Full-fledged Islamic banking service.**

The third one is full-fledged Islamic banking service. Once a conventional bank has operated an Islamic window for some time and has gathered a sizeable customer base for its Islamic banking service activities, it may decide to establish an Islamic subsidiary, or even fully convert into a full-fledged Islamic bank. By following either of these two routes, the bank may benefit from economies of scope and concentration of knowledge and expertise. The bank will be able to offer a wider range of Shariah-compliant banking products than through the Islamic window alone. For example, it may be better equipped to fully engage in Islamic investment banking activities, such as underwriting sukuk (bond) issuances or managing Shariah-compliant investment and hedge funds, or to manage its own treasury and money market operations.

### **2.4. Challenges of Islamic Banking/Interest free banking**

Over the last 20 years we have seen the establishment of several of Islamic banks and financing companies as well as Islamic banking windows as banks have rushed to satisfy the appetite of investors and consumers for Sharia compliant products (Rasheed Al Maraj, 2007). Despite these encouraging developments, and the increasing cooperation between conventional bankers and those seeking specialist financing consistent with the *Shari'ah*, there are several shortcomings as far as what is on offer is concerned (Wilson, 2000). For example, according to (Ibrahim & Adnan, 2017), some of the challenges that have to be addressed for the successful introduction and operation of Islamic banking are listed as follows and the ideas are also supported by other authors including Bello and Abubaker (2014), Louis and Ahmed (2014), and Nafees, Masum, Ahmed & Hassan, (2018).

#### **2.4.1. Lack of knowledge, skills and technical capacity to regulate, and supervise the system**

These challenges relate to Lack of human resource, lack of education and lack of awareness creation, and absence of legislation on shariah governance (Nafees et al, 2018, Ibrahim et al, 2017).

##### **a. Lack of human resource**

With regards to challenges of human resource, it is noted that one of the major bottlenecks for the development of the Islamic banking industry is the scarcity of trained human resources. They are the main factors for any successful venture. As Islamic banking is a newcomer to the banking sector in the developing countries, it needs trained and well-equipped people who have the knowledge of the Shariah, economics and banking in order to convince the masses towards

this new business. Only committed and skilled personnel imbued with Islamic ethical values and norms can be instrumental in marketing the products and enhancing the new system of banking. The author also mentioned the idea of Muzzam Ali and agreed with the notion that “even the injunction of sufficient funds cannot ensure the success of a financial organization, if there is not an adequate supply of capable trained and committed people to run it” (Ali, 2005) and suggested that having the qualified human resource for Islamic banking services is very important.

#### **b. Lack of education and lack of awareness creation**

With respect to education and awareness creation Nafees et al (2018) mentioned that the creation of understanding of the Shariah principles and developing knowledge on Islamic modes of business and investment, both among Muslims and non-Muslims, is a big task. Sincere efforts are required to be put in place without further delay to set up demand and appeal in accordance with the principles and philosophy of Islamic banking. Failure to do so will result in certainly serious disturbance and devastation in the market, creating systematic risk for the emerging industry. People must be made to understand by way of a broad campaign that Islamic banking savers and customers can reasonably enjoy a return on the basis of the nature of the transactions and the result of the business activity undertaken by the parties involved in utilizing funds. More importantly, priority must be given for the religious leaders at the grass-roots level to be taught about these aspects that will be passed on to the public successfully (Bala et al 2009 pp36).

Concerning knowledge about Islamic banking, it is stated that by Nafees et al (2018) that knowledge about Islamic transactions is crucial to deal with its transactions. People should have a basic understanding of the fundamentals of Islam, especially the prohibition of riba (usury) gharar (uncertainty) and the right understanding on fiqhmuamalat (Islamic law of transactions). It is observed that most of the IBIs do not have a Research & Development division to analyse the situation and educate the people on this area. It is, therefore, suggested that IBIs may make a joint venture to establish a common body, which would be involved in research, train the human resource and educate the masses. Equally, Islamic movements and Muslim NGOs also have a crucial role to play.

#### **c. Absence of legislation on shariah governance**

Besides, it is noted by Nafeemetal (2018) that absence of legislation on Shariah governance is one of main problems the Islamic banking industry. Shariah governance can only endorse transactions are in conformity with the Shariah.

#### **2.4.2. Lack of Shariah-compliant liquidity management instruments**

Islamic banks cannot invest their excess liquidity in interest-based instruments, which are the liquidity management instruments in the market, which places them at a competitive disadvantage with respect to their conventional counterparts. Also the current inter-bank market and the instruments used by the Central Bank for monetary policy operations are all interest-based with no equivalent government securities or other money market instruments that are Shariah-compliant, all of which are essential to avoid a liquidity bottleneck for Islamic banks when they come into operation.

#### **2.4.3. Absence of Islamic Insurance**

Absence of Islamic insurance (Takaful) to protect investments of Islamic banks against unforeseen hazards and facilitate the growth of the industry respectively. Closely connected with this challenge is the lack of a deposit insurance scheme for the protection of depositors of Islamic banks.

#### **2.4.4. Lack of Knowledge of accounting and auditing standards**

Lack of knowledge of accounting and auditing standards pertinent to Islamic financial institutions. The balance-sheet structure of Islamic banks is unique, and even though the work of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) on accounting and auditing standards for Islamic banking products is available, there is the need to train conventional accountants and auditors in the application of the standards.

#### **2.4.5. Lack of a robust and comprehensive legal framework**

The lack of robust and comprehensive legal framework is a challenge, especially at the level of adjudication/settlement/resolution of conflicts involving Islamic finance contracts, products or entities.

#### **2.4.6. Lack of Shariah Scholars**

Dearth of Shariah scholars knowledgeable in conventional economics, law, accounting, banking and finance, which places severe constraints on the regulatory Shariah-compliance mechanism.

### **2.4.7. Double Taxation**

Double taxation that would be levied on Islamic banks as a result of stamp duties and capital gains tax that is deductable upon asset transfer. Islamic banks face a tremendous challenge in this respect because their financial intermediation is asset-based. In home financing for example, the Islamic banks take possession of the asset either through sale or construction contract, and they pay stamp duty for that. When they resell the asset to a customer through a mark-up sale or a lease ending with ownership contract, another stamp duty is charged for the asset transfer. Other jurisdictions, including the UK and Luxembourg have modified their tax laws to exempt Islamic banks from double taxation on assets they acquire for financing purposes. Thus, authors such as Bello and Abubaker (2014); Louis and Ahmed (2014), indicated the main challenges of Islamic banking include Shari'ah related Issues, lack of awareness and understanding, regulatory challenges, Absence of Liquidity Instruments, Inadequate Human resource, absence of a secondary Islamic financial market. Likewise, (Nafees, Masum, Ahmed, & Hassan, 2018) listed the problems/challenges faced by the Islamic banking industry as the lack of human resources and education, the lack of awareness creation and absence of legislation on *Shari'ah* governance.

### **2.5. Prospects of Islamic banking/Interest free banking**

This section demonstrates the prospects of Islamic banking. Some of the prospects of Islamic banking are economic growth, attraction of investors, and fostering of egalitarian society are the likely prospects for the establishment of the Islamic banking. It concludes that Islamic banking system will bring transformation to all sectors of the economy vis-a viz eradication of poverty, equitable distribution of income and employment opportunities in the country through effective mobilization and allocation of capital (Akmel, 2015). More specifically, the author enumerated the prospects of Islamic banking as follows: it helps as a means to reach those potential customers who were far from the banks due to interest application and answer the requests of those deprived from the conventional banking service; it helps to create additional source of deposit to the banks and attract the potential customers who were discouraged by the conventional banking interest application; due to application of various loan service modalities which Islamic banking applies help for attraction of investors and it fosters economic growth and investment.



## 2.6. Empirical Review

This section outlines empirical review on the challenges and prospects of Islamic banking. Accordingly, with regards to the challenges of Islamic banking, a study conducted in Lebanon, which is one of the developing countries in the world, Saleh and Zeitung (2005) found out that the major challenges of Islamic banking are lack of public awareness and acceptance, lack of research and development institutions, inadequate manpower, and high competition from conventional banks offering Islamic windows. Another empirical finding regarding the challenges of Islamic banking are provided by Njanike (2010), who examined the problems of Islamic banking in Zimbabwe. The author identified the major challenges of Islamic banking to be unnecessary political intervention in the selection of borrowers, financial instability, inability of the government to restore law and order in the country, resistance from the banking community, inadequate infrastructure for information dissemination, inconsistency in policy making and implementation of the fiscal and monetary authorities, Central bank control and supervision of Islamic banking with unqualified persons in Islamic finance, absence of Islamic interbank, misperception, and current unstable political and economic situation in the country.

Besides, Amin (2008) who studied Islamic banking practices in a form of E-business in Malaysia, indicated that challenges of Islamic e-business in general are lack of consumer acceptance, pricing in Islamic e-business, the need for complex infrastructure, and legal risks issues. Further, Jabr (2003), who investigated Islamic banking challenges and prospects in Palestine, concludes that the challenges and prospects of Islamic banks operating in the Palestinian territories are as follows: Lack of adequate banking law for Islamic banking; existence of unproductive money; lack of awareness; lack of operational difference between Islamic and conventional banks; Islamic banking lacks the ability to channel deposits into long-term investment; lack of experience in Islamic Shari'ah; excessive short-term financial instrument; inability to make use of Mudaraba and Musharaka financial institutions; inferior technical resources and technology; Islamic banks are compelled to recruit staff trained in traditional banking; inability to differentiate ownership from management; and lack of financial innovations.

More so, Sanusi (2011) cited in Bello (2014) explored the challenges of Islamic banking in Nigeria, and consequently the study found out that the challenges of Islamic banking in Nigeria are inadequate manpower, lack of Shari'ah – compliant liquidity management instruments, lack

of Islamic insurance (Takaful), lack of knowledge of accounting and auditing standard required by Islamic financial institutions, inadequate legal framework, lack of Shari'ah scholars knowledgeable in conventional economics, law, accounting, banking and finance, problem of multiple taxation, lack of tax relief on Islamic banking profits, and misperception of Islamic banking. Finally, Bello (2014) who studied the challenges of Islamic banking in Nigeria discovered that the major challenges are either institutional or operational. The author noted that challenges of Islamic banking in Nigeria are institutional challenges such as inappropriate institutional framework, inadequate legal framework, lack of equity institutions, poor supervisory framework, disparity in accounting standard, lack of secondary financial markets such as Takaful, which is Islamic insurance, and lack of short-term financial instruments and institutions. The operational challenges occur in the form of 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.

Concerning prospects of Islamic banking, there are also certain empirical evidence to consider. For example, according to Amin (2008) Islamic financial system liberalization (Amin, 2008), in hi study of e-business from Islamic perspective in Malaysia uncovered that the prospects of e-business depend on government support, Islamic financial system liberalization, economies of scale, the improvement in manpower, and growing users of the service. Akram, Rafique, and Alam (2011), on the other hand, who studied prospects of Islamic banking in Pakistan identified the fact that Islamic banking is growing and the tendency that it will keep growing further in the future as prospects. They have also identified the potential that greater efficiency will more satisfy customers as an additional prospect.

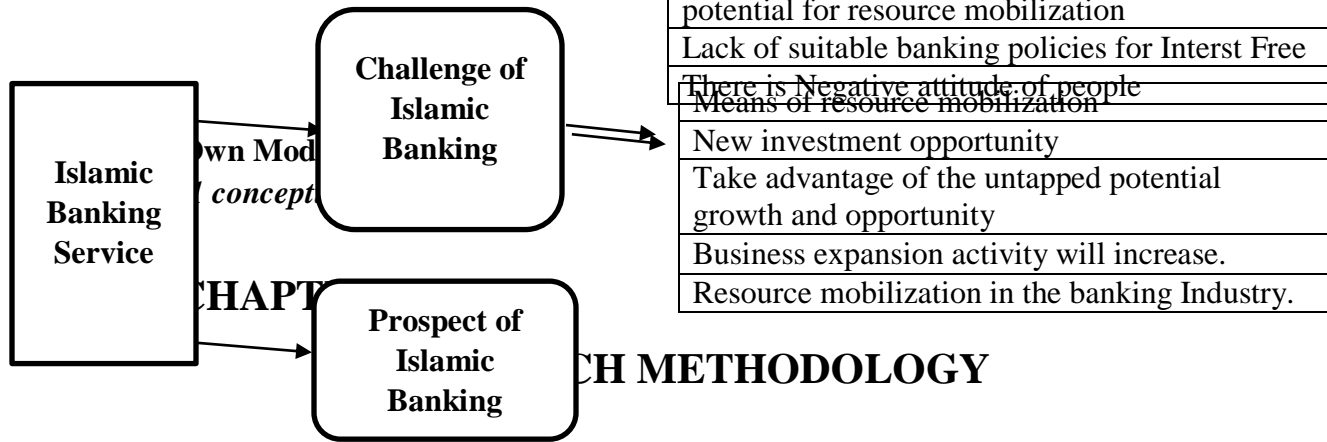
## **2.7. Conceptual Framework**

Based on the literature review (both theoretical and empirical) above and in light of the research objective of the study which is investigating the challenges and prospects of Islamic banking in Commercial Bank of Ethiopia (Eastern Addis Ababa District), the following conceptual framework is developed. Among others, the conceptual framework will be very helpful in designing the questionnaire.

### **Islamic Banking (Challenges and Prospects)**

Community awareness problem
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Table 2: Conceptual framework developed based on the theoretical and empirical review of this study



*The aim of this section was to highlight the overall methodological content of the research. Which contains research design, target population, sampling techniques used, determination of sample size and population, data collection techniques, and finally, presents the data analysis approach.*

### 3.1 Research Approach and Design

This research applied a survey design with descriptive approach using mixed method. i.e Both Quantitative and qualitative approaches. As the topic of the study is a contemporary issue, applying descriptive approach was appropriate (Patton, 2002; Yin, 2003). 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 and it is quite often used in social science and business research.

In brief, according to Kothari (2004), there are several methods of collecting primary data, particularly in surveys and descriptive researches. Important ones are through questionnaires and interview methods. This research applied the same survey design with descriptive approach using questionnaires and interviews.

### 3.2 Target Population

A population can be defined as all people or items with the characteristics that one wishes to study (Kothari, 2004). Commercial Bank of Ethiopia has totally fifteen districts in Ethiopia

based on location (Annual Report 2019/2020). Branches that are located in 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 in terms of time and cost, Eastern Addis Ababa District of the bank was considered in this research.

The population of this study corresponds to the employees and clients of Interest Free services/windows of 32 branches of Eastern Addis Ababa District of CBE. These 32 branches were selected as representative sample of branches. Based on Carvalho (1984) approach and as large sample size is always the most preferred, this study chose a large sample size for number of branches, which is 32 because the number of branches in Eastern Addis Ababa district that offered Interest Free banking was 106, which fell in the range (N= 91-150) in line with the Carvalho (1984). Therefore, the total number of deposit clients (customers) in East district branches of CBE are 16,296 from 32 branches. These branches were selected because they had larger number of clients/customers than the other branches.

### 3.3. Sampling Design

The respondents were drawn from bank clients and employees of Eastern District of CBE. Before determining the sample size of clients and employees, the research determined the sample size for branches. So, that means sampling was done at least at three stages: branch, clients, and employees of Eastern District in Addis Ababa.

#### 3.3.1. Sampling Branches

First, sample of branches from the East Addis Ababa District was selected using Carvalho (1984) approach and as large sample size is always the most preferred. Therefore, 32 branches which provide Islamic banking were selected among 106 branches. This falls in the range (N= 91-150) as shown in the Carvalho table below. Hill (1998) affirms that "large samples are essential". The guideline provided by Carvalho to be used in this study is shown below.

**Table 3.1: Sample Size Determination**

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

Large	20	32	50	80	125	200	315	500	800
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Source: Carvalho (1984)

### 3.3.2.Sampling Clients

Research methodologists such as Kothari (2004) suggest that the size of sample should neither be excessively large, nor too small. It should be optimum and an optimum sample is one which fulfills the requirements of efficiency and flexibility (Kothari, 2004). In view of this, Roscoe (1975), Abranovic (1997) and Hill (1998) stated that samples larger than 30 are acceptable. In this research, used commonly determine large population sample. , during this study to create the sample was determined representatives, the sample size of the study was decided victimization the formula adopted from (Yamane, 1967).

Thus, the formula used to calculate the sample size is

The formula is given below:

$$n = \frac{N}{1 + N(e)^2}$$

Where:

- + n= sample size
- + e= is the desired level of precision (i.e. the margin of error),+5% (a 95% confidence level)
- + N = the population size
- + 1=probability of event occurring
- + Z= 1.96

Hence, the sample size for clients becomes

$$n = \frac{16296}{1 + 16296(0.05)^2}$$

$$n = 390$$

**Table 3.2: Proportional distribution of questionnaire**

No.	Branches	Total Numberof Customer	Percentage From Total Population	Total Number Of Customer Sample
1	Figa Mazoria	88	0.5%	2
2	Jakkros	339	2.08%	8
3	Beshalie	1146	7.03	27
4	Ayat Mekodonya	38	0.2%	1

5	CMC	1340	8.2%	32
6	CMC Michael	556	3.4%	13
7	Gerji	1453	8.9%	35
8	Goro Adebabay	1326	8.1%	32
9	Gurd Sholla	1501	9.2%	36
10	Hayahulet Mazonia	347	2.1%	8
11	Haile Gebresilassie Avenue	396	2.4%	9
12	Korean Hospital	1532	9.4%	37
13	Lem Area	333	2%	8
14	Lamberet	255	1.6%	6
15	Megenagna	727	4.4%	17
16	Meri	1069	6.3%	25
17	Gerji-Giorgis	476	2.9%	11
18	Sefera Lemi	93	0.5%	2
19	Misrak	53	0.3%	2
20	Sholla Akababi	299	1.8%	7.
21	Dejazmach Wondyrad	65	0.39%	2
22	Imperial Akababi	339	2.08%	8
23	Gerji Mebrat	244	1.49%	6
24	Misrak Dil	144	0.88%	3
25	Balderas	200	1.22%	5
26	Loke	291	1.78%	8
27	Karamara	94	0.57%	2
28	Chefe Ayat	175	1.07%	4
29	Summit Condominium	157	0.96%	4
30	Summit Safari Branch	14	0.08%	1
31	Woji	290	1.77%	7
32	Yerer Ber	916	5.62%	22
	Total	<b>16296</b>	<b>~100%</b>	<b>390</b>

Source: Own survey result, (2021)

### **3.3.3.Sampling Employees**

Moreover, it should be noted that since Interst Free banking is done in Commercial Ban of Ethiopia based on a window model, two employees were contacted from each window in the selected branches. Questionnaires were distributed to two employees from each branch, because CBE assigned only two employees to each Islamic banking window. Thus, a total of 64 employees (32 branches x 2 employees) filled the questionnaires. In both cases the samples were greater than 30, and they are deemed acceptable (Hill, 1998).

Then using convenience sampling approach questionnaires were distributed to readily available branches and respondents and this was deliberate sampling, which is one of the widely used sampling techniques in research. According to Kothari (2004) “deliberate sampling is also known as purposive or non-probability sampling. This sampling method involves purposive or deliberate selection of particular units of the universe for constituting a sample which represents the universe. When population elements are selected for inclusion in the sample based on the ease of access, it can be called convenience sampling.”

### **3.4. Source and Types of Data**

This research used primary data source that were generated using questionnaires and interviews. Questionnaires distributed to the clients, employees, and managers of the branches. In addition, interviews were conducted with certain managers of the branches that were rendering Islamic banking services. So, the major form of the data were numeric which were collected using questionnaire.

### **3.5.Data Collection Instruments**

The data collection instruments were questionnaire and interview. As indicated above the questionnaires were distributed to the clients and employees of the targeted branches of Commercial Bank of Ethiopia. With regard to the questionnaire instrument, the researcher developed it following writing the literature review. The questionnaire consisted of structured questions using a Likert Scale which have five rating scale i.e strongly disagree, Disagree, Neutral, Agree and strongly agree. Questionnaires with likert scale were commonly used instruments in surveys. In line with this Kothari (2004) stated that whether it is sample surveys

or census surveys, then we can obtain primary data either through observation or through direct communication with respondents in one form.

In order to address the first research question, which states “What are the Islamic banking products that are offered?” interviews conducted with managers of the branches. In addition, secondary sources such as Commercial Bank Ethiopia’s website and documents were accessed to identify the types of Islamic banking services/products it offers.

In dealing with the second and the third research questions that states “What are the challenges of Islamic banking?” and “What are the prospects of Islamic banking?” respectively, the study used a questionnaire.

### 3.6.Data Analysis Approach

After the data have been collected, the researcher turns to the task of analyzing them (Kothari, 2004). Accordingly, quantitative and qualitative (mixed) approach were utilized to perform the analysis. Interview and observations analysed through qualitative discussion. This means quantitative approach followed descriptive analysis that performed on the data collected using questionnaire. The results were depicted using tabulations that show percentages, frequencies and mean values using statistical package for social science (SPSS) version 26.

### 3.7 Reliability Test

Validity is key in evaluating measures in the thesis. During this thesis, the analysis is valid as a result of the collected data and also the research questions are in a systematic manner. The questionnaire were developed once looking out different similar researches. So, that the questionnaires adopted from other similar researches, it's famed to be valid.

In order to make sure the reliability of thesis the author had conducted the pre-test of reliability by taking of thirty sample questionnaires for clients and fifteen questionnaires for staff. In keeping with Martyr & Mallery (2003), states that it's suggested that if a Cronbach’s constant of a scale exceeds 0.70 is appropriate as internally consistent, so more analysis may be carried unless it's unacceptable.

**Table 3.3 Validity and Reliability test**

Dimensions	Cronbach's Alpha Value	Number of items
Challenge for staff	0.974	16



Prospect for staff	0.816	9
Overall Reliability for Staff	0.969	25
Challenge for Clients	0.932	16
Prospect for Clients	0.906	9
Overall Reliability for Clients	0.959	25

Source: Own survey result, (2021)

### 3.8 Ethical Considerations

Researchers have to take care of various other issues at different stages of the research process. Both the researcher and participants have an important role to play. Researchers have to take care of the participants' right and must consider their research from participants' perspective ( Huma Parveen and Nayeem Showkat, 2006).

The research was conducted after getting ethical approval from concerned organs. First the researcher requested the permission of CBE to access the documents of the bank and to get major customers from selected branches to fill the questionnaires.

Moreover the questionnaire on its introduction explain purpose of the research will be academic purpose and to keep respondents data confidentiality the research uses the codes instead of name and other personal information related data.

Finally the respondent included based on their willingness and then the questionnaires distributed to voluntary participants only.

## CHAPTER FOUR

### DATA ANALYSIS AND DISCUSSION

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*In this chapter the researcher present and discuss on demographic data of respondents, the reliability of data, challenge and prospect of Islamic Banking using the questionnaire data as well as interview. The analysis was dominantly descriptive analyses.*

*To conduct this research total of 355 questionnaire were distributed to selected branches client as well as 60 questionnaire were distributed to Interest Free Banking window staffs in selected branches.*

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#### **4.1. Background of the Respondents**

In this section personal profile of respondents which 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 have been summarized. Descriptive statistics has been used to analyze the demographic data.

##### **4.1.1 Background of Employees**

This section provides a brief description of the profile/characteristics of the respondent employees in order to highlight their composition in terms of their demographic characteristics, which include: Gender, level of education, work experience, and occupation.

As the table 4.1 shows 41 (68.33%) employees are male while 19, (31.67%) are female on the other hand have master's degree, 34(56.66) employees have BA degree and the rest 5 (8.33%) of employees diploma holders.

With regards to the overall experience of employees, 18(30%) respondents have a working experience between 1 and 5 years. Majority of employees, 38 (63.33%) have a working experience between 6 to 10 years. Besides 4 (6.67%) employees have 11 to 15 years of working experience

Regarding the employees experience in the Islamic banking service, 35(58.33%) employees worked for over three years in Islamic banking. The other 20(33.33%) has 1 to 2 years of working experience in the area. The rest 5 (8.33%) worked in the area under one year. In general demographic information implies that the researcher do not suffer from demographic variable biase.

**Table 4.1: Background Information of Employee**

Valid	Gender	Frequency	Percent
	Male	41	68.33
Female	19	31.67	
Total	60	100.00	
Qualification			
Valid	Diploma	5	8.33
	BA/BSC	34	56.66
	Master	21	35
	Total	60	100.00
Year of Experience			
Valid	1-5 years	18	30
	6-10 years	38	63.33
	11-15 years	4	6.67
	Total	60	100.00
Valid	IFB Year of service		
	1 year	5	8.33
	1-2 year	20	33.33
	Over 3 years	35	59.34
	Total	60	100.00

Source: Own survey result, (2021)

### 4.1.2. Background Information of Clients

This section (Table 4.2) provides a brief overview of the profile of the client respondents. It is important to note that the researcher managed to collect 355 fully completed questionnaires out of 390 distributed questionnaires.

With regard to product choice, as shown in table 4.2 below, 83 (34.44%) used Wadiah Amanah, 50 (20.75%) used Qured, 105(43.57%) use Amanah and the rest 3 (1.24%) clients used Mudaraba. Accordingly, with respect to religion, the majority of the respondents/clients(241 or 67.8%) were Muslims, while the rest 114(32.2%) were non-Muslims. This very important mix to know the common understanding of Islamic Banking service by the society.

**Table 4.2: Religion of respondents**

Valid	Religion	Frequency	Percent
	Muslim	241	67.88
	Non-Muslim	114	32.12
	Total	355	100.00
Type of account customer have			
Valid	wadiah amanah	83	34.44
	Qured	50	20.75
	Amanah	105	43.57
	Mudaraba	3	1.24
	Total	241	100.0

Source: Own survey result, (2021)

### 4.2. Reliability Test Statistics

According to Bhattacharjee (2012) reliability is the degree to which the measure of a construct is consistent or dependable. It implies consistency but not accuracy the most popular test of internal consistency is the Cronbach's alpha. The higher the coefficients, the better the measuring instrument, that is if  $\alpha$  is greater than 0.7, it means that it has high reliability (Hair, et al., 2006).

Further, according to George and Mallery (2003), (as cited in Joseph & Rosemary, 2003) Cronbach's alpha is a coefficient of reliability. It is commonly used as a measure of the internal consistence or reliability of a **psychometric test score for a sample of examinees**. Cronbach's alpha reliability coefficient normally ranges between 0 and 1. The following table shows the reliability decision rule.

**Table 4.3: Cronbach's Alpha**

Cronbach's Alpha	Description
$\geq .9$	Excellent
$\geq .8$ but $< .9$	Good
$\geq .7$ but $< .8$	Acceptable
$\geq .6$ but $< .7$	Questionable
$\geq .5$ but $< .6$	Poor
$\leq .5$	Unacceptable

Source: Zikmund, et al., 2010.

In this study the Cronbach's alpha's test result is above 0.8. In addition towards validity and reliability, the questionnaire was reliable with excellent alpha value except prospect dimension of the staff, and minor improvements were made on the questionnaire following the feedback from the pilot test. The reliability statistics of the implies that the questionnaire used in analysis is more than enough for futher analysis.

**Table 4.4: Reliability analysis (Cronbach's Alpha)**

Dimensions	Cronbach's Alpha Value	Number of items
Challenge for staff	0.955	16
Prospect for staff	0.831	9
Overall Reliability for Staff	0.958	25
Challenge for Clients	0.949	16
Prospect for Clients	0.968	9
Overall Reliability for Clients	0.968	25

Source: Own survey result, (2021)

### 4.3. Analysis and Presentation

#### 4.3.1. Presentation of findings and analysis - Itemized analysis

This section deals with the analysis and interpretation of data that obtained from the response collected through the distributed questionnaire. First itemized analysis done for the data collected from clients and that will be followed by itemized analysis of the data obtained from employees.

### 4.3.2.1. Analysis of Data from Clients

As it can be noted from the conceptual framework and the questionnaire, the data collected focused on two major dimensions. The first one is challenges and the second is prospects. The findings of challenges are outlined first and it will be followed by prospects.

#### 4.3.2.1.1. Challenges of Islamic Banking

*Table 4.5: Challenges of Islamic Banking Client Responses*

Item		Responses and Rates						Mean
		SD	D	N	A	SA	Total	
Lack of public awareness & acceptance	N	0	6	0	212	137	355	4.35
	%	0	1.7	0	59.7	38.6	100	
There is inadequate manpower in the Windows that provide Islamic banking and the sector in general	N	26	50	0	177	102	355	3.38
	%	7.2	14.1	0	49.9	28.8	100	
There is a gap in research and development in Islamic banking services and Islamic finance modalities to fill the gap in qualified human resource.	N	0	28	25	168	134	355	4.15
	%	0	7.89	7.04	47.33	37.74	100	
There is high competition from conventional banks	N	0	134	49	172	0	355	3.10
	%	0	37.7	13.8	48.5	0	100	
There is resistance from the banking community against Islamic banking	N	40	0	41	274	0	355	3.55
	%	11.3	0	11.5	77.2	0	100	

There exists inadequate infrastructure for information dissemination	N	24	25	25	281	0	355	3.90
	%	6.8	7	7	79.2	0	100	
There is lack of consumer acceptance of Islamic banking	N	0	26	15	274	40	355	3.60
	%	0	7.3	4.2	77.2	11.3	100	
There is lack of adequate banking law for Islamic banking	N	26	50	0	177	102	355	3.38
	%	7.2	14.1	0	49.9	28.8	100	
here is lack of experience in Islamic Shari'ah	N	22	0	20	149	164	355	4.2
	%	6.2	0	5.6	42	46.2	100	
The use of staff trained in traditional banking than Islamic banking is a challenge	N	37	0	39	197	82	355	3.98
	%	10.4	0	11	55.5	23.1	100	
There is lack of financial innovation (in Islamic banking products)	N	0	0	40	278	37	355	3.99
	%	0	0	11.3	78.3	10.4	100	
There is lack of secondary market (Such as Takaful/Islamic Insurance)	N	38	38	0	85	194	355	4.00
	%	10.7	10.7	0	24	54.6	100	
There is inadequate legal and supervisory framework	N	35	0	79	163	78	355	3.70
	%	9.9	0	22.2	45.9	22	100	
There is lack of segregation of fund between Islamic banking and conventional banking	N	0	74	0	124	157	355	3.60
	%	0	20.8	0	35	44.2	100	
There exists misperception of Islamic banking (negative attitude of people regarding Islamic banking)	N	4	0	0	298	53	355	4.10
	%	1.1	0	0	84	14.9	100	

There is lack of awareness creation campaigns about Islamic banking	N	37	43	0	81	194	355	4.00
	%	10.4	12.1	0	22.8	54.7		

Source: Own survey result, (2021)

As the table 4.5 clearly depict, in judging whether there is lack of public awareness and acceptance to Islamic banking, 137 (38.6%) and 212 (59.7%) strongly agree and agree respectively that there is lack of public awareness and acceptance of Islamic banking. It is only 6 respondents (1.7%) who disagree on this fact. so, the finding confirms that there is lack of public awareness and acceptance about Islamic banking. In addition, when we see the mean value, 4.35 is above the threshold (average) inclined to agreeing that there is lack of public awareness and acceptance.

With respect to manpower inadequacy results as shown in the above table hold that 177(49.9%) Agree and 102 (28.8%) strongly agree that there is manpower inadequacy. Whereas, 26 (7.2%) Strongly Disagree and 50(14.1%) Disagree. In short, the majority assert that there is manpower inadequacy. In addition, the mean value of 3.38 also indicates that majority of respondents agreed that there is inadequate man power.

In relation to the gap in research and development the result as shown in the above table indicate that 168 (47.3%) Agree, 134 (37.7%) Strongly agree, whereas 28 (7.9%) Disagree and 25 (7.04%) neutral so that due to the data we can see that majority of respondents agree that there is a gap in research and development. Also, the mean value of 4.15 above average indicates that the respondents agreed on there is a gap in research and development.

With respect to competition from conventional banks the result shows that 172(48.5%) Agree, 49(13.8%)Neutral and 134(37.7%) disagree.The mean score value is also 3.1. In general, the data show that the competition from conventional banks results at average.

Based on the table above findings show that the majority of respondents 274 (77.2%) agree that there is resistance from the banking community to Islamic banking. Only 40 (11.3%) disagree within this position. The mean value 3.6 also verifies that there is high resistance to



Islamic banking from the banking community. So, the finding confirms that there is high resistance

Concerning the existence of inadequate infrastructure for information dissemination, 274 (77.2%) agree and 40 (11.3%) strongly agree that there is inadequate infrastructure. Only a small proportion of 26 (7.3%) respondents disagree on this. Moreover, this is also verified by the mean value 3.9, that there is inadequate infrastructure.

Regarding to consumer acceptance, findings indicate that the majority of the respondents 238 (67%) confirm that there is lack of consumer acceptance of Islamic banking. It is only 39 (11%) respondents who disagreed on the matter. The mean value is also 3.6 suggesting lack of consumer acceptance of the service.

In assessing the item whether there is lack of adequate banking law for Islamic banking or not, the majority of the respondents 281 (79.2%), affirmed with their agreement that there is lack of adequate banking law for Islamic banking in the country. It is only 49 (13.8%) respondents who disagreed that there is lack of adequate laws. The mean value 3.6 also shows that there is lack of adequate banking law pertaining to Islamic banking.

Regarding lack of experience in Islamic Shari'ah, findings indicate that the majority of the respondents 164 (46.2%) strongly agree and 149 (42%) agree that there is lack of experience in Islamic shariah. Its only 22 (6.2%) respondents who disagree on the issue. The mean value 4.2 also indicate that there is lack of experience in Islamic shariah

In relation to the challenge of the use of staff trained in traditional banking than Islamic banking, the majority of the respondents 279(78.6%), confirmed with their agreement that there is use of staff trained in traditional banking than Islamic banking the mean value 3.98 indicate that above average which confirmed that use of staff trained in traditional banking than Islamic banking is a challenge.

Regarding lack of financial innovations (in Islamic banking products), findings indicate that the majority of the respondents 315(88.7%) confirmed their agreement. The mean value 3.99 indicates that there is lack of financial innovations (in Islamic banking products).

Regarding the question whether there is lack of secondary market (Such as Takaful/Islamic insurance) or not, findings indicate that the majority of the respondents 194(54.6%) strongly agree and 85(24%) agree that there is lack of secondary market. The mean value 4 also indicates that there is lack of secondary market such as Takaful/Islamic insurance.

As the table above shows, in judging whether there is inadequate legal and supervisory framework or not; 78 (22%) and 163 (45.9%) strongly agree and agree respectively shows that there is inadequate legal and supervisory framework. However, 35 (9.9%) respondents disagree on the matter. The mean value, 3.7 also indicate that there is inadequate legal and supervisory framework.

Regarding the question of whether there is lack of segregation of fund between Islamic banking and conventional banking, findings indicate that the majority of the respondents 281(79.2%) confirmed their agreement. It is only 74 (20.8%) respondents who disagree on this fact. And the mean value score is 4. In general, the finding confirms that there is lack of segregation of fund between Islamic banking and conventional banking,

With respect to misperception of Islamic; results as shown in the table above hold that 298 (84%) agree and 53 (14.9%) strongly agree that people perceive Islamic banking negatively. Only 4 (1.1%) respondents disagree on the fact in short, the majority assert that there is misperception of Islamic banking. In addition, the mean value of 4.1 also indicates that majority of respondents agreed that there exists misperception of Islamic banking (negative attitude of people regarding Islamic banking),

Regarding awareness creation campaign, the majority of the respondents confirm that there is lack of awareness creation campaign, more specifically, 194 (54.7%) respondents stated that they strongly agree that there is lack of awareness creation campaign, 81 (22.8%) agree that there is the same problem. Those who disagreed were 37 (12.1%) respondents and those who strongly disagreed were 37 (10.4) respondents. The mean score value 4 also verifies that there is lack of awareness creation campaign about Islamic banking service.

**4.3.2.1.2. Prospects of Islamic banking**

There are listed of items which deal with respondents’ views on prospects of Islamic Banking in the banking sector. In order to assess the prospects of Islamic banking, the items that were utilized included bellow the table.

**Table 4.6 : Prospect of Islamic Banking Client Responses**

Item	Response rate							Mean
	SD	D	N	A	SA	Total		

Islamic financial system liberalization	N	48	39	0	158	110	355	3.70
	%	13.5	11	0	44.5	31	100	
Growing users of the service (Islamic banking is growing)	N	18	30	56	80	171	355	4.00
	%	5	8.5	15.8	22.5	48.2	100	
Islamic banking contributes to economic growth	N	0	42	38	159	116	355	3.70
	%	0	11.8	10.7	44.8	32.7	100	
Islamic banking has an important role to attract investors	N	0	48	0	116	191	355	4.30
	%	0	13.5	0	32.7	53.8	100	
Islamic banking fosters /promotes egalitarian society	N	0	0	78	236	41	355	3.90
	%	0	0	22	66.5	11.5	100	
Islamic banking contributes to expand employment opportunities in the country	N	0	14	0	192	149	355	4.3
	%	0	3.9	0	54.1	42	100	
Banking interest application	N	0	0	0	275	80	355	4.2
	%	0	0	0	77.5	22.5	100	
Islamic banking represents additional deposit to banks	N	0	0	40	125	190	355	4.4
	%	0	0	11.3	35.2	53.5	100	
Islamic banking will have contribution to support and expand local businesses	N	0	0	36	163	156	355	4.3
	%	0	0	10.2	45.9	43.9	100	

Source: Own survey result, (2021)

Regarding the idea of Islamic financial system liberalization; the analysis according to the table above indicates that majority of respondents 158 (44.5%) and 110 (31%) agree and strongly agree respectively whereas 48 (13.5%) respondents strongly disagree and 39 (11%) respondents disagree. In general, majority of respondents confirm their agreement on the issue. The mean score value 3.7 verifies that there is a prospect that there will be more of Islamic financial system liberalization.

In assessing the item whether there is growing of users of the service; the data collected from the clients in brief describes the agreement on the matter from the respondent 171 (48.2%) and 80 (22.5%) strongly agree and agree respectively only 18 (5%) and 30 (8.5%) respondents

are strongly disagree and disagree respectively on the fact. The mean score value 4 also confirms that there is growing of users of the service.

Following that contribution for economic growth Concerning Islamic banking's contribution to economic growth; 159 (44.8%) agree and 116 (32.7%) strongly agree that Islamic banking contributes to economic growth. Only a small proportion of 42 (11.7%) respondents disagree on this. Moreover, this is also verified by the mean value 4, that Islamic banking contributes to economic growth.

As the table depict the majority of respondents 307 (86.5%) agree that Islamic banking has an important role to attract investors/investment to the county. Only 48 (13.5%) respondents disagree with this position. The mean value 4.3 also verifies that Islamic banking has an important role to attract investors/investment. So, the finding confirms that Islamic banking has an important role to attract investors/investment to the country. Therefore, there is a need for the same supportive financial markets are necessary (Akmel, 2015).

Regarding the bank's contribution regarding equitable distribution of income in the country; the majority of respondents 236 (66.5%) and 41 (11.5%) agree and strongly agree respectively that the bank has contribution to equitable distribution of income. The mean value 3.9 also verifies that Islamic banking fosters/promotes egalitarian society (contributing to equitable distribution of income).

Concerning the contribution of expanding employment opportunities in the country; 192 (54.1%) agree and 149 (42%) strongly agree that Islamic banking contributes to expand employment opportunities in the country. Only a small proportion 14 (3.9%) of respondents disagree on this. Moreover, this is also verified by the mean value 4.3. Therefore, it can be concluded that Islamic banking contributes to expand employment opportunities in the country.

As regards to the data collected; all respondents confirm their agreement with the idea that states "Islamic banking facilitates financial inclusion (attract the potential customers who were discouraged by the conventional banking interest application)". All of the respondents 355 (100%) agreed on the idea. Besides, the mean value 4. verifies that Islamic banking facilities financial inclusion. Concerning with the item "Islamic banking represents additional deposit to banks" almost all respondents 315(88.7%) confirms their agreement. The mean value (4.4) verifies that Islamic banking represent additional deposit to the bank.

Regarding to Islamic banking's contribution to support and expand local businesses by providing saving and loan service. The finding indicates that majority of respondents 163(45.9%) and 156(43.9%) agree and strongly agree respectively. Majority of respondents confirm their agreement on the issue. The mean value 4.3 also verifies that Islamic banking will have contribution to support and expand local businesses by providing saving and loan service.

#### 4.3.2.2. Analysis Data from Employees

The data collected on the employee's perspective listed as follow the findings of challenges is outlined first and it is followed by prospects.

##### 4.3.2.2.1. Challenges of Islamic banking

In order to assess the challenges of Islamic banking, the items that were utilized include:

The analyses of the findings on the challenges are presented as follows:

**Table 4.7 Challenge of Islamic Banking Staffs Response**

Item		Responses and Rates						Mean
		SD	D	N	A	SA	Total	
There is lack of public awareness and acceptance	N	0	8	10	32	10	60	3.70
	%	0	13.3	16.7	53.3	16.7	100	
There is inadequate manpower that provide Islamic banking	N	6	28	5	16	5	60	2.77
	%	10	46.7	8.3	26.7	8.3	100	
There is a gap in research and development in Islamic banking services and Islamic finance modalities	N	0	0	20	24	16	60	3.90
	%	0	0	33.3	40	26.7	100	
There is high competition from conventional banks	N	18	29	5	6	2	60	2.10
	%	30	48.3	8.3	10	3.3	100	
There is resistance from the banking community against Islamic banking"	N	15	15	6	24	0	60	2.70
	%	25	25	10	40	0	100	
There exists inadequate infrastructure for information dissemination.	N	0	9	20	22	9	60	3.50
	%	0	15	33.3	36.7	15	100	
There is lack of consumer acceptance of Islamic banking	N	9	9	18	20	4	60	3.00
	%	15	15	30	33.3	6.7	100	

There is lack of adequate banking law for Islamic banking	N	5	9	9	33	4	60	3.40
	%	8.3	15	15	55	6.7	100	
There is lack of experience in Islamic Shari'ah	N	0	9	13	29	9	60	3.60
	%	0	15	21.7	48.3	15	100	
The use of staff trained in traditional banking than Islamic banking is a	N	8	19	6	22	5	60	2.95
	%	13.3	31.7	10	36.6	8.3	100	
There is lack of financial innovations (in Islamic banking products)	N	5	10	18	18	9	60	3.30
	%	8.3	16.7	30	30	15	100	
There is lack of secondary market (Such as Takaful/Islamic insurance)	N	0	6	27	18	9	60	3.50
	%	0	10	45	30	15	100	
There is inadequate legal and supervisory framework	N	5	9	6	35	5	60	3.50
	%	8.3	15	10	58.3	8.3	100	
There is lack of segregation of fund between Islamic banking and conventional banking”	N	9	9	0	10	32	60	3.80
	%	15	15	0	16.7	53.3	100	
There exists misperception of Islamic banking (negative attitude of people regarding Islamic banking)	N	3	16	6	20	15	60	3.60
	%	5	26.7	10	33.3	25	100	
There is lack of awareness creation campaigns about Islamic banking	N	4	0	14	33	9	60	3.70
	%	6.7	0	23.3	55	15	100	

Source: Own survey result, (2021)

In relation to public awareness and acceptance; the collected data from 60 employees verifies their agreement on the issue as shown in table 4.7, 32 (53.3%) and 10 (16.7%) agree and strongly agree respectively confirms that there is lack of public awareness and acceptance of Islamic banking. It is only 8 respondents (13.3%) who disagree on this fact. The finding confirms that there is lack of public awareness and acceptance about Islamic banking. In addition, the mean score value, 3.7 is above the average inclined to agreeing that there is lack of public awareness and acceptance.

With respect to the item in relation to adequacy of manpower in the windows that provide Islamic banking and the sector in general; results as shown in the table hold that majority of the

respondents confirms their disagreement on the matter 6 (10%) strongly disagree and 28 (46.7%) disagree that there is manpower inadequacy. Whereas, 5 (8.3%) strongly agree and 16 (26.7%) agree. In short, on the view of employees the majority assert that there is no manpower inadequacy. In addition, the mean value 2.77 also indicates that majority of respondents disagree that there is inadequate man power.

Concerning the gap in research and development in Islamic banking services and Islamic finance modalities to fill the gap in qualified human resource; the data collected from the employees in brief described the agreement on the matter. From the respondents 16 (26.7%) and 24 (40%) responded strongly agree and agree respectively. The mean value 3.9 confirms that there is a gap in research and development in Islamic banking services and Islamic finance modalities to fill the gap in qualified human resource.

With respect to competition from conventional banks; on the view of employees majority of respondents confirms their disagreement 18(30%)strongly disagree and 29(48.3%) disagree only 8 (13.3%) respondents agree on the issue. Therefore, it can be concluded that there is no competition of Islamic banking service from conventional one. The mean value 2.1 below average verifies there is no competition.

Concerning the resistance from the banking community against Islamic banking; majority of respondents disagree on the matter. 30 (50%) disagree and 24 (40%) agree that there is resistance from the banking community against Islamic banking whereas the mean value 2.7 below average verifies there is no resistance from the banking community against Islamic banking.

In relation to the existence of adequate infrastructure for information dissemination; the data collected from employees in brief describes the agreement on the matter. From the respondents 9 (15%) and 22 (36.7%) strongly agree and agree respectively. The mean value 3.5 confirms that there exists inadequate infrastructure for information dissemination.

With respect to the idea related to consumer acceptance of Islamic banking; 24 (40%) respondents agree on the issue and 18 (30%) respondents confirms their disagreement. The mean score value 3 shows that it is on average. Regarding the banking law for Islamic banking; majority of respondents confirms their agreement. From the respondents 33 (55%) agree and 4 (6.7%) strongly agree whereas 9 (15%) respondents disagree and 5 (8.3) respondents strongly

disagree on the matter. The mean value 3.4 describe that there is lack of adequate banking law for Islamic banking.

As the table above shows majority of respondents 38 (63.3%) believed that there is lack of experience in Islamic Shariah. Only 9 (15%) respondents disagree on the matter. Moreover, this is also verified by the mean value of 3.6. In general, there is lack of experience in Islamic Shari'ah. In concerning with the use of staff trained in traditional banking than Islamic banking is a challenge; 8 (13.3%) respondents strongly disagree and 19 (31.7) disagrees while 22 (36.6%) and 5 (8.3%) agree and strongly agree respectively. The mean value 2.95 describe that it is on average.

Regarding the question of whether there is lack of financial innovations (in Islamic banking products), findings indicate that respondents 27 (45%) confirmed their agreement 15 (25%) respondents confirms their disagreement whereas the mean value 3.3 indicates that there is lack of

Concerning with the idea of lack of secondary market (Such as Takaful/Islamic insurance) on the employees perspective majority of the respondents agree on the issue 27 (45%) only 6 (10%) respondents confirm their disagreement while the mean value 3.5 describes above average so it can be concluded that there is lack of secondary market (Such as Takaful/Islamic insurance).

Regarding the adequacy of legal and supervisory framework; majority of respondents confirms their agreement. Among the respondents 14 (23.3%) respondents disagree on the matter whereas 40 (66.6%) agree. The mean value 3.5 describe that there is inadequate legal and supervisory framework.

Concerning segregation of fund between Islamic banking and conventional banking; the finding shows that 42 (70%) confirms their agreement whereas 18 (30%) disagree on the matter however the mean value 3.8 verifies that there is lack of segregation of fund between Islamic banking and conventional banking. With respect to the perception of Islamic Banking; results as shown in the table above hold that 20 (33.3%) agree and 15 (25%) strongly agree that there is misperception. While 16 (26.7%) respondents disagree and 3 (5%) strongly disagree on the fact. In short, the majority assert that there is misperception of Islamic banking. In addition, the mean value of 3.6 also indicate that majority of respondents agreed that, there exists misperception of Islamic banking (negative attitude of people regarding Islamic banking),



In relation to awareness creation campaigns about Islamic banking; the collected data from the employees in brief describes the agreement on the matter. Among the respondents 9 (15%) and 33 (55%) strongly agree and agree respectively, only 4 (6.7%) strongly disagree. The mean value (3.7) confirms that there is lack of awareness creation campaigns about Islamic banking.

#### 4.3.2.2.2. Prospects of Islamic banking

There are listed items which deal with employees view on prospects of Islamic Banking in the banking sector. In order to assess the prospects of Islamic banking, the items that were utilized include:-

The analysis of the findings on the prospects are discussed as follows.

**Table 4.8 Prospect of Islamic Banking Staffs Responses**

Item	Response rate							Mean
		SD	D	N	A	SA	Total	
More of Islamic financial system liberalization	N	4	13	11	14	18	60	3.50
	%	6.7	21.7	18.3	23.3	30	100	
Islamic banking is growing and the tendency that it will keep growing	N	4	0	9	14	33	60	4.20
	%	6.7	0	15	23.3	55	100	
Islamic banking contributes to economic growth	N	5	9	0	10	36	60	4.10
	%	8.3	15	0	16.7	60	100	
Islamic banking has an important role to attract investors	N	0	14	0	11	35	60	4.10
	%	0	23.3	0	18.3	58.3	100	
Islamic banking fosters promotes egalitariansociety	N	0	5	22	14	19	60	3.80
	%	0	8.3	36.7	23.3	31.7	100	
Islamic banking contributes to expand employment opportunities in the country	N	0	0	14	24	22	60	4.10
	%	0	0	23.3	40	36.7	100	
Islamic banking facilitates financial inclusion	N	0	0	14	15	31	60	4.30
	%	0	0	23.3	25	51.7	100	
Islamic banking represents additional deposit to banks	N	4	0	14	10	32	60	4.10
	%	6.7	0	23.3	16.7	53.3	100	
Islamic banking will have contribution to support and expand local businesses	N	0	0	0	13	47	60	4.80
	%	0	0	0	21.7	78.3	100	

Source: Own survey result, (2021)

Regarding to Islamic financial system liberalization; the analysis indicate that majority of respondents 14 (23.3%) and 18 (30%) agree and strongly agree respectively. Whereas 4 (6.7%) respondents strongly disagree and 13 (21.7%) respondents disagree. In general, majority of respondents confirm their agreement on the issue. Mean score value 3.5 verifies that there is a prospect that there will be more of Islamic financial system liberalization

With respect to the item of growing users of the service results as shown in the table below hold that 47 (78.3%) agree that there will be growing users of the service (Islamic banking is growing and the tendency that it will keep growing further in the future). Only 4 (6.7%) respondents disagree on the fact. In short, the majority of respondents assert that there will be growing users of the service (Islamic banking is growing and the tendency that it will keep growing further in the future). In addition, the mean value 4.2 also verifies that there will be growing users of the service (Islamic banking is growing and the tendency that it will keep growing further in the future).

Concerning the issue of contribution of Islamic banking to economic growth; 10 (16.7%) agree and 36 (60%) strongly agree that Islamic banking contributes to economic growth. Only a small proportion of respondents 14 (23.3%) disagree on this. Moreover, this is also verified by the mean score value 4.1, that Islamic banking contributes to economic growth. Concerning with the item in relation to attracting investors/investment to the county; the analysis in the table above indicates that majority of respondents 46 (76.6%) confirms their agreement on the issue only 14(23.3%) respondents disagree. While mean value 4.1 above average verifies that Islamic banking has an important role to attract investors/investment to the county.

The other issue raised was Islamic bankings' contribution to equitable distribution of income in the country. Results as shown in the table below hold that 33 (55%) agree that Islamic banking fosters/promotes egalitarian society (contributing to equitable distribution of income) in the country. Only 5 (8.3) respondents disagree on the fact. While the mean value 3.8 verifies that Islamic banking fosters/promotes egalitarian society (contributing to equitable distribution of income) in the country. As the table above shows majority of respondents 46 (76.7%) agree on that Islamic banking contributes to expand employment opportunities in the country. Also, the mean value 4.1 above average verifies that Islamic banking contributes to expand employment

opportunities in the country. Concerning with the item related to Islamic banking facilitates financial inclusion (attract the potential customers who were discouraged by the conventional banking interest application ) the analysis indicates that majority of respondents 31 (77.5%) confirms their agreement. The mean value 4.3 which is above average verifies that Islamic banking facilitates financial inclusion (attract the potential customers who were discouraged by the conventional banking interest application ).

With respect to additional deposit to the banks; among 60 employee respondents, 42 (70%) of them agree on that Islamic banking represents additional deposit to the banks. Only 4 (6.7) respondents disagree on the fact. While the mean score value 4.1 verifies that Islamic banking represents additional deposit to the banks. In relation to the idea of Islamic bankings' contribution to support and expand local businesses (by providing Saving and loan Service); the data collected from employees shows that all the 60 (100%) respondents verify their agreement on the issue. The mean score value 4.8 is above the average inclined to agreeing that Islamic banking will have contribution to support and expand local businesses (by providing Saving and loan Service).

In general there are several potential opportunities for Interest free finance in Ethiopia. Among these opportunities, the first one is the availability of huge potential customers who have been excluded from accessing conventional finance products and services mainly due to religious reasons. The success of every business is mainly depending on the availability of potential customers who can access the products and services provided. As the basic principles of Islamic finance are originated from Sharia rules, it is expected to be Muslims are the primary customers for Interest free finance products and services. According to the World Population Review (2019) estimation, the population of Ethiopian reached 113 million and 34% (38.5 million) out of the total population are Muslims (Suadiq M,200 pp126). The availability of a substantial Muslim population is the primary potential opportunity for the expansion of Interest free finance in Ethiopia. The ever increasing number of banks providing IFB service in window and subsidiary model, and customers who have accounts in these window services is another indicator of huge amount of potential customer. In 2018 only Oromia International bank and Cooperative bank of Oromia had 248,614 and 660,000 customers of IFB respectively (Aman, 2019).

#### 4.4. Interview analysis

In order to demonstrate the types of Islamic banking services that the bank offers to clients, interview was conducted with the branch manager of Eastern. More precisely, the question that was posed in the interview and company document review are: What are the modes of Islamic operation of CBE, i.e., the types of Islamic banking products and services that is provided?

Accordingly, in line with the question, it is found out that the bank offers a variety of Islamic banking products to its clients, which include : Wadiah Amanah (Safe keeping saving), Qured, Amanah (current account), Mudaraba, Safe keeping and Qured, and Safe keeping and Mudaraba. Further information about these types of products is found in the bank's website document (online document), [www.combanketh.et/IFB](http://www.combanketh.et/IFB). Some details regarding the types of the Islamic banking products (especially, Wadiah Amanah; Qured (Qard); Amanah; and Mudharabah (profit sharing saving account) that are found in this online document is described below.

**Wadiah Amanah(saving with guarantee):-** This type of account is opened for unspecified length of time by customers who own the funds in the Bank for safekeeping. Depositors give their consent to the Bank to deal with the whole or any part of their monies in the manner that it deems fit, so long as it is not against sharia. The Bank will guarantee repayment of the whole sum or any outstanding part in the depositor account without any interest when demanded.

**Qured (Qard)** – it is a shariah complaint product. It is opened to all Ethiopian citizens and permanent residents. For this deposit product, the bank issues cheques specifically designed for this purpose.

**Amanah** - This is interest-free current account opened for unspecified length of time and managed through checks until the depositor demands payment and is paid promptly/right away.

**Mudharabah (profit sharing saving account)** - This is a type of investment partnership where a customer deposits money for unspecified length of time and the Bank shares both the profit and loss with her/him. The customer may withdraw his/her deposit at any time, but the Bank may impose some restrictions on the amount to be taken out as this arrangement is both profit and loss sharing partnership.

Moreover, lack of awareness, regulatory and supervisory challenges, institutional challenges, lack of support and link institutions, gap in research and development in Islamic studies as, lack

of qualified human resource as well as wrongful association with specific religion and the global terrorism movements in recent.

## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

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*The primary purpose of this study has been to assess Challenges and Prospects of Interst Free/ Islamic Banking in Commercial Bank of Ethiopia (Eastern District). Based on the findings of the study, this chapter presents the summary, conclusions policy implication and Future research direction.*

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#### 5.1. Summary

The main objective of the paper was to assess what challenges faced by commercial bank of Ethiopia in eastern district of Addis Ababa and what prospects that the Islamic banking service holds. As it was noted in the methodology and analysis chapters, questionnaires were the main data collection instrument that has been administered with the employees and clients of commercial banks. As was noted 355 questionnaires that were distributed to Islamic banking customers and 60 questionnaires that were distributed to the employees of the bank used for analysis.

Findings show that the major types of Islamic banking products that the bank offers include: Wadiah Amanah (Safe keeping saving), Qured, Amanah (current account), Mudaraba, Safe keeping and Qured, and Safe keeping and Mudaraba.

The study's major findings in line with the challenges of Islamic banking service of the bank include:-

So in this case gap of performance occurs by lack in terms of awareness on this products by the clients, and ineffective marketing, promoting, doubled tax policy, types of IFB products , nonexistence of IFB products in every braches, IFB operation limitation in window model, absence of trustship and confidentiality. There is lack of public awareness and acceptance, There is inadequate manpower in the Windows that provide Islamic banking and the sector in general, There is a gap in research and development in Islamic banking, There is high competition from conventional banks, resistance from the banking community against Islamic banking, adequacy of infrastructure for information dissemination, consumer acceptance of Islamic banking, adequacy of banking law for Islamic banking and experience in Islamic Shari'ah,

Regarding the prospects of the Islamic banking service, the study found out the following to be major opportunities/prospects:

Islamic financial system liberalization, growing users of the service (Islamic banking is growing and the tendency that it will keep growing further in the future),contribution for economic growth, attractiveness of investors/investment to the county, contribution to equitable distribution of income in the country, expansion of employment opportunities in the country. Attractiveness of potential customers who were discouraged by the conventional banking interest application ), additional deposit to banks, contribution to support and expand local businesses (by providing saving and loan service)

## **5.2. Conclusions**

Based on the findings of the study the following conclusions are made. Speaking of challenges and prospects the study concludes the following as the main prospects of Islamic banking in the country.

There is lack of public awareness and acceptance about Islamic banking service and with regard to adequacy of man power there are two opposite perspectives on the view of clients there is inadequate man power but employees oppose the issue. Since, clients are ultimately the ones who judge the quality of service, the clients concerns should be taken into account. The study

also found out that the bank is not working towards creating more awareness about Islamic banking.

The study revealed that the bank's officials are not working diligently on awareness creation.

The findings of the study also revealed that there exists inadequate infrastructure for information dissemination and consumer acceptance of Islamic banking is in query. Also the study exposed there is lack of adequate banking law for Islamic banking due to these experience in Islamic shariah is low also there is inadequate legal and supervisory framework

Islamic banking service has a potential to attract investors because of these there will be growing users of the service (Islamic banking is growing and the tendency that it will keep growing further in the future) which brings contribution for economic growth. Islamic banking will have contribution to support and expand local businesses (by providing Saving and loan Service when the service expand it creates employment opportunities and the service represents additional deposit to the bank.

### **5.3 Theoretical Contribution and Policy Implication**

Based on the aforementioned conclusions, the researcher recommends the following points.

In order to create awareness and acceptance to the public commercial bank needs to create awareness by using the marketing tools. Officers of the bank should play a vital role in educating the public about Islamic banking products. In order to have well trained man power there must be training program. Most of the training given to the officers and staff of banks are in line with the conventional banking system. Compared to conventional banking concepts, Islamic banking is a contemporary issue with new discipline and has distinct rules and principles. Since many of their employees do not know the difference between their products, This implies for a need of training for the employees.

The service of Islamic banking is not only for Muslims also the followers of other religion can access the service but majority of the followers of other faiths have little or no knowledge about it at all. So the bank must work more on marketing to introduce that the service is based on non interest, not on religion. For every financial organization deposit is a vital and crucial issue for the existence of the sector in order to increase the deposit of the bank, the bank has encourage the clients to place their deposit with Islamic banking by employing good marketing techniques.

Officials of the banks should play a vital role in educating the public about Islamic banking products. More effort should be made by Islamic banks to market their products. Several promotional campaigns should be planned. In order to create the appropriate knowledgeable staff, banks should design training programs in the field of Islamic banking, and marketing, communication, Internal marketing to their employees is of high priority. Since many of their employees do not know the difference between their products, and those of conventional banks. Since deposit works as life blood for any bank's Progress. Therefore, in order to promote Islamic banking, it is also fundamental for Islamic banks to offer good products for mass majority in order to induce them to place their deposits with Islamic banks. Banks can capture large deposits by employing good marketing techniques.

In order to properly implement the service requirement, national bank of Ethiopia needs to establish a clear set of legal frame work to control the proper establishment of the Shari'ah Control Committee of Islamic Banks, Due to the fact that Islamic banking has religious dimension, financial innovations in this institution needs to meet Shari'ah requirements. Majority Muslims only know that Islamic banking is based on non-interest basis, while the majority of the followers of other faiths have little or no knowledge about it at all. This creates lag to Islamic banking by creating lack of public acceptance.

#### **5.4. Limitation and Future Research Directions**

The researcher believes that the following had significant bearing on the quality of the research limitations and future research direction:-

- Lack of related literatures in the Ethiopian context and reference books.
- Because of time the research is limited to city branches, so rural area branches were not included in the study,
- The research on the same area make widens the scope.
- The recommendation drawn from the research was as per selected branches means others.
- Limited collaboration from different stakeholders to fully cooperate for the in-depth interviews.



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*(Addis Fortune: The Oromia International Bank (OIB) became the first bank in Ethiopia to launch interest-free banking (IFB), after the Commercial Bank of Ethiopia (CBE) on December 16, 2013. Accessed on October 8, 2018*

## **Appendix I Questionnaire**

### **Questionnaire to Staff**

**St. Mary's University**

**MBA Program**

**Solomon Y.**

**Contract Address: ++251-9886380**

**Email: solomonicyimer2011@gmail.com**

**Dear Respondents,**

This questionnaire is designed to collect data on the topic 'challenges and prospects of Islamic Banking in Commercial bank of Ethiopia (Eastern District). The purpose of the study is for the partial fulfillment of the requirement for MBA program. For the successful accomplishment of the study, the response of employees who work in Islamic banking windows of the bank will have pivotal role to obtain useful insights. I assure you that the information to be shared by you

will be used only for academic purpose and kept confidential. So, you are kindly requested to genuinely fill the questionnaire.

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

Instruction: -

- Writing your name is not required.
- Put “✓” Mark as per the question required in the box or answer in the space provided.

## **Part II- Demographic Characteristics**

1. Gender

- Male
- Female

2. Please indicate your educational qualification.

- Diploma
- BA/BSC
- Master's
- PHD

3. How many years of experience do you have in the banking sector?

- 1-5 years
- 6-10 years
- 11-15 years
- 16 years and above

4. How long have you been working in interest free/ Islamic banking?

- Less than 1 year
- 1-2 year
- 2-3 year
- Over 3 years

No	Items	Strongly Disagree(1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly Agree (5)
1	There is lack of public awareness and acceptance	0	8	10	32	10

2	There is inadequate manpower in the Windows that provide Islamic banking and the sector in general	6	28	5	16	5
3	There is a gap in research and development in Islamic banking services and Islamic finance modalities to fill the gap in qualified human resource.	0	0	20	24	16
4	There is high competition from conventional banks	18	29	5	6	2
5	There is resistance from the banking community against Islamic banking	15	15	6	24	0
6	There exists inadequate infrastructure for information dissemination	0	9	20	22	9
7	There is lack of consumer acceptance of Islamic banking	9	9	18	20	4
8	There is lack of adequate banking law for Islamic banking	5	9	9	33	4
9	There is lack of experience in Islamic Shari'ah	0	9	13	29	9
10	The use of staff trained in traditional banking than Islamic banking is a challenge	8	19	6	22	5
11	There is lack of financial innovation (in Islamic banking products)	5	10	18	18	9
12	There is lack of secondary market (Such as Takaful/Islamic Insurance)	0	6	27	18	9
13	There is inadequate legal and supervisory	5	9	6	35	5

	framework					
14	There is lack of segregation of fund between Islamic banking and conventional banking	9	9	0	10	32
15	There exists misperception of Islamic banking (negative attitude of people regarding Islamic banking)	3	16	6	20	15
16	There is lack of awareness creation campaigns about Islamic banking	4	0	14	33	9

**Would you please list down additional challenges that you face related to Islamic banking in Ethiopia?**

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_
5. \_\_\_\_\_
6. \_\_\_\_\_

**Part III- Prospects of Islamic Banking**

Next, there are listed to items which deal with respondents view on prospects of Islamic Banking in the banking sector. These items will explore respondent’s assessment of challenges facing in the banking sector. So please tick the number that you feel most appropriate, using the scale from 1 to 5 (Where 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree and 5= Strongly Agree).

No	Items	Strongly Disagree	Disagree	Neutral (3)	Agree	Strongly Agree
1	There is a prospect that there will be more of Islamic financial system liberalization	4	13	11	14	18
2	There will be growing users of the service (Islamic banking is growing and the tendency that it will keep growing	4	0	9	14	33



	further in the future)					
3	Islamic banking contributes to economic growth	5	9	0	10	36
4	Islamic banking has an important role to attract investors /investment to the country	0	14	0	11	35
5	Islamic banking fosters/promotes egalitarian society (contribution to equitable distribution of income) in the country	0	5	22	14	19
6	Islamic banking contributes to expand employment opportunities in the country	0	0	14	24	22
7	Islamic banking facilitates financial inclusion (attract the potential customers who were discouraged by the conventional banking interest application	0	0	14	15	31
8	Islamic banking represents additional deposit to bank	4	0	14	10	32
9	Islamic banking will have contribution to support and expand local business (by providing Saving and loan Service)	0	0	0	13	47

**Would you please list down additional prospects that you face related to Islamic banking in Ethiopia?**

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_
5. \_\_\_\_\_
6. \_\_\_\_\_

**Questionnaire to Clients**  
**St. Mary's University**  
**MBA Program**

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**Dear Respondents,**

This questionnaire is designed to collect data on the topic 'challenges and prospects of Islamic Banking in Commercial bank of Ethiopia (Eastern District). The purpose of the study is for the partial fulfillment of the requirement for MBA program. For the successful accomplishment of the study, the response of employees who work in Islamic banking windows of the bank will have pivotal role to obtain useful insights. I assure you that the information to be shared by you will be used only for academic purpose and kept confidential. So, you are kindly requested to genuinely fill the questionnaire.

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

Instruction: -

- Writing your name is not required.
- Put “✓” Mark as per the question required in the box or answer in the space provided.

**Part I- Demographic Characteristics**

1. Would you please indicate your religion?

Muslim

Non –Muslim

2. Which interest free/Islamic banking product (s) of CBE do you use?

- Wadiah Amanah (Safe keeping saving)
- Qured
- Amanah (current account)
- Mudaraba
- Safe keeping and Qured
- Safe keeping and Mudaraba

**Part II- Challenges of Islamic Banking**

Next, there are listed to items which deal with respondents view on challenges facing Islamic Banking in the banking sector. These items will explore respondent’s assessment of challenges facing Islamic banking. So please tick the number that you feel most appropriate, using the scale from 1 to 5 (Where 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree and 5= Strongly Agree)

	Items	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
1	There is lack of public awareness and acceptance	0	6	0	212	137
2	There is inadequate manpower in the Windows that provide Islamic banking and the sector in general	26	50	0	177	102
3	There is a gap in research and development in Islamic banking services and Islamic finance modalities to fill the gap in qualified human resource.	0	28	25	168	134

4	There is high competition from conventional banks	0	134	49	172	0
5	There is resistance from the banking community against Islamic banking	40	0	41	274	0
6	There exists inadequate infrastructure for information dissemination	0	26	15	274	40
7	There is lack of consumer acceptance of Islamic banking	0	39	78	238	0
8	There is lack of adequate banking law for Islamic banking	24	25	25	281	0
9	There is lack of experience in Islamic Shari'ah	22	0	20	149	164
10	The use of staff trained in traditional banking than Islamic banking is a challenge	37	0	39	197	82
11	There is lack of financial innovation (in Islamic banking products)	0	0	40	278	37
12	There is lack of secondary market (Such as Takaful/Islamic Insurance)	38	38	0	85	194
13	There is inadequate legal and supervisory framework	35	0	79	163	78
14	There is lack of segregation of fund between Islamic banking and conventional banking	0	74	0	124	157
15	There exists misperception of Islamic banking (negative attitude of people regarding Islamic banking)	4	0	0	298	53
16	There is lack of awareness creation campaigns about Islamic banking	37	43	0	81	194

**Would you please list down additional challenges that you face related to Islamic banking in Ethiopia?**

7. \_\_\_\_\_

8. \_\_\_\_\_
9. \_\_\_\_\_
10. \_\_\_\_\_
11. \_\_\_\_\_
12. \_\_\_\_\_

### Part III- Prospects of Islamic Banking

Next, there are listed to items which deal with respondents view on prospects of Islamic Banking in the banking sector. These items will explore respondent's assessment of challenges facing in the banking sector. So please tick the number that you feel most appropriate, using the scale from 1 to 5 (Where 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree and 5= Strongly Agree).

No	Items	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
1	There is a prospect that there will be more of Islamic financial system liberalization	48	39	0	158	110
2	There will be growing users of the service (Islamic banking is growing and the tendency that it will keep growing further in the future)	18	30	56	80	171
3	Islamic banking contributes to economic growth	0	72	38	159	116
4	Islamic banking has an important role to attract investors /investment to the country	0	48	0	116	191
5	Islamic banking fosters/promotes egalitarian society (contribution to equitable distribution of income) in the country	0	0	78	236	41
6	Islamic banking contributes to expand employment opportunities in the country	0	14	0	192	149
7	Islamic banking facilitates financial inclusion (attract the potential customers who were discouraged by the conventional banking interest application	0	0	0	275	80
8	Islamic banking represents additional deposit to bank	0	0	40	125	190
9	Islamic banking will have contribution to support and expand local business (by providing Saving and loan Service)	0	0	36	163	156

**Would you please list down additional prospects that you face related to Islamic banking in Ethiopia?**

- 7. \_\_\_\_\_
- 8. \_\_\_\_\_
- 9. \_\_\_\_\_
- 10. \_\_\_\_\_
- 11. \_\_\_\_\_
- 12. \_\_\_\_\_