



**ASSESSMENT OF CHALLENGES AND OPPORTUNITIES OF  
INTEREST FREE BANKING IN ETHIOPIA IN THE CASE OF BANK OF  
ABYSSINIA, ADDIS ABABA CITY ADMINISTRATION**

**BY**

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January 2025

Addis Ababa, Ethiopia



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**A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY, SCHOOL OF  
GRADUATE STUDIES IN PARTIAL FULFILLMENT OF THE  
REQUIREMENTS FOR THE DEGREE OF MASTER OF ART IN  
PROJECT MANAGEMENT**

January 2025

Addis Ababa, Ethiopia

**ST MARY'S UNIVERSITY**  
**SCHOOL OF GRADUATE STUDIES**  
**FACULTY OF BUSINESS**  
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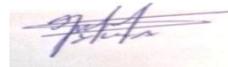
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Declaration

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of my advisor Hailemeleket Taye (Asst. Professor) All sources of material used for the thesis have been duly acknowledged, I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree

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## **ENDORSEMENT**

This thesis has been submitted to St Mary's University, school of Graduate Studies for Examination with my approval as a university advisor.

Hailemeleket Taye (Asst. Professor)



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St Mary's University, Addis Ababa, January 2025

## **Acknowledgment**

First of all may all praise be to the Almighty GOD for the giving me the strength, patience and guidance to endure and complete this research paper. I would like to express my admiration to my advisor Hailemeleket Taye (Asst. Professor) for his invaluable comments and encouragement during the process of this research undertaking.

On the other hand, group-wise acknowledgment is forwarded to all reference used in this thesis and respondents of questionnaires.

Last but not least; my gratitude goes to my family members for their unprecedented support across the whole of my study in general and the research thesis in particular, with special thanks to all staff members of Bank of Abyssinia especially and also to my brothers and my beloved sister.

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## ACRONYMS

BOA	Bank of Abyssinia
CBE	Commercial Bank of Ethiopia
COB	Cooperative Bank of Oromia
IFB	Interest Free Banking
IFBW	Interest Free Banking Window
IS	Islamic Banking
NBE	National Bank of Ethiopia
NIB	International Bank,
SPSS	Statistical package for social science
UB	United Bank

## **Abstract**

*The aim of this research was to analyze the challenges and opportunities of interest-free banking in the context of Bank of Abyssinia S.C. the study approach of the study was a mixed based study approach and the study design for the study was descriptive based study design. The population of this study included directors, managers, and officers, of Bank of Abyssinia S.C those have a direct relation with interest free banking service. A descriptive study was done on respondents from of Bank of Abyssinia S.C by distributing structured questionnaires to the study participant of Bank of Abyssinia S.C who had direct contact to interest-free banking service; conducted by collected data from 109 respondents at Bank of Abyssinia. The findings showed that lack of awareness among potential customers on interest-free banking services, and a shortage of trained professional to operate were the primary challenges of interest-free banking. On the other hand, opportunities like untapped market on interest-free banking may be taken as an advantage or opportunity to its products and services, which would specialize in providing interest-free banking products and services using customer happiness as a specialism.*

**Key word:** *Interest free banking, opportunities, challenges, descriptive, Bank of Abyssinia*

# **CHAPTER ONE**

## **INTRODUCTION**

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

Over the past 10 years, Islamic finance, often known as interest-free banking, has grown rapidly, and its banking industry has become systemically important in many countries across many different fields. According to IMF estimates from 2015, Islamic finance is expected to continue expanding in response to economic development in countries with large Muslim populations that are mainly unbanked. Another driving factor is the substantial sums of money that numerous oil-exporting countries have saved up and are ready to invest in Shari'ah-compliant financial goods.

The impact of Islamic finance is growing, which may have several benefits. For instance, it is sometimes said that Islamic banking is inherently less susceptible to crises since its risk-sharing component reduces leverage and encourages better risk management on the behalf of financial institutions and their customers. Islamic finance is said to be more stable than conventional finance because it discourages speculation; (ii) financing in Islamic finance is asset-based and completely collateralized; and (iii) it is founded on morally upright values. Islamic financial institutions (IFIs) are seen as a great platform for promoting financial inclusion, facilitating SMEs' access to capital, and supporting growth and economic development (IMF, 2015)

Islamic finance expanded throughout the Middle East aggressively, and currently, it is stretching out in all parts of the world. According to the Global Islamic Finance Report (GIFR, 2019), The total capital of Islamic finance has reached US\$2.6 trillion at the end of 2018 with a 6.58% annual growth rate. Indonesia, Malaysia, Iran, Saudi Arabia, Sudan, Brunei Darussalam, UAE, Bangladesh, Kuwait and Pakistan are the top 10 leading countries in Islamic finance Industry. Based on the total share from the global Islamic finance asset, the leading sectors in 2018 are Islamic banking, Sukuk, Islamic funds and Takaful with 71.7%, 24.2%, 2.8% and 1.3% shares respectively (IFSB, 2019).

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

Now days, interest free banking business is growing at a faster rate because of the interest free system and many developed countries have started to look at it as the alternative from their conventional banking system (Abduljelil and Khalilur 2014). Interest free banks are institution that mobilize financial resources and invest them in an attempt to achieve predetermined interest free acceptable social and financial objectives (Abduljelil and Khalilur 2014).

Currently, the interest free banking policies is very broad and does not provide any specificity in terms of product lines, rules and regulations to ensure that the products developed by financial institutions are truly in line with Sharia Law. Hence, a review of current policy is needed to provide viable alternatives to roll out interest free banking in Ethiopia.

In interest free banking services, there are some methods of financing such as Mudaraba, Musharaka, Murabaha, and Ijarah which provide all the contractual details of the business and some contracts are based on profit and loss sharing schemes. Islamic financial order is based on Sharia which is based on risk sharing between parties and there is not fully burden on one party. Interest free banking is not only for Muslim community because it provides moral and more ethical concept of financing and investment. (Olad, 2012).

Interest free banking is growing rapidly for the past four decades, and this banking service has become significantly important in a dozen countries in a wide range of regions. Interest free banking is projected to continue to grow in response to economic growth in countries with large and relatively unbanked Muslim society. It is also fueled by the large savings accumulated by many oil-exporting countries that are seeking to invest in Sharia-compliant financial products. (Wendwosen, 2018)

In implementing this banking business the bank should also to note how the customer should be served and who answers client questions. Everyone who works on interest free banking service should understand Islamic finance principles. Islamic banking operational training of the staffs is not only about religious concepts, the product knowledge that leads the staffs to understand how Islamic banking is different from conventional banking (Wendwosen, 2018).

### **Background of the organization**

The present-day Bank of Abyssinia was established on February 15, 1996 (90 years to the day after the first but defunct private bank was established in 1906 during Emperor Menelik II) in accordance with 1960 Ethiopian commercial code and the Licensing and Supervision of Banking Business Proclamation No. 84/1994. BOA started its operation with an authorized and paid up capital of Birr 50 million, and Birr 17.8 million respectively, and with only 131 shareholders and 32 staff. In two decades since its establishment, Bank of Abyssinia has registered a significant growth in paid up capital and total asset. It also attracted many professional staff members, valuable shareholders and large customers from all walks of life. This performance indicates public confidence in the Bank and reliability and satisfaction in its services. Operators like Western Union, Money Gram, Express Money, Dahabshiil, TransFast, Ria, World Remit & Kaah (Haregeweyn, 2022).

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

Banks are one of the main deposit taking institutions by opening their doors to the general public to give their valuable services by identifying their customers and categorically designing the service need of these special customers through the effort of satisfying their banking requirements. Among these specialized services designed to serve the customers is interest free banking service window or section besides with their conventional banking service. Interest free banking window is a business model in which conventional banks offer interest free banking products and services from their existing branch network. (Sanui, 2011)

In Ethiopia now days, various banks start interests free banking service windows besides their conventional banking activities. Although the banks start this type of Islamic banking services there is lack of confidence in the business community about the service. This is because they mainly focus on the deposit accepting motives from those who don't want interest only. According to Haque (2019), customer perception about interest free banking is being influenced significantly by quality of services, confidence in bank, social and religious perspective and availability of services. In addition to this the collected fund need to be used for financing of those interests free products only because accepting and paying of interest is prohibited by Islamic law. The Ethiopian banking institutions starting these interest free banking services and as based on the above facts will face many challenges in their operational activity of resource mobilization. Beyond this there is also growth of opportunities for attempting to identify unidentified problems; the study was focus on assessing challenges and opportunity of interest free banking service in resource mobilization efforts of Abyssinian bank S.C.

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

development in this institution, lack of profit sharing finance, inability to adequately mobilize deposits, competition, and finally globalization.

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

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

In Ethiopia few studies were conducted on the attributes of IFB. Among these studies Mohammed (2012) studied the prospects, opportunities and challenges of Islamic Banking in Ethiopia" and showed the potential challenges to be lack of awareness, regulatory and supervisory challenges, institutional challenges, lack of support and link institutions, gap in research and development in Islamic studies, lack of qualified human resource as well as wrong association with specific religion and the global terrorism. Because the study area focused on Jijga City and it show only on the implementation of one type of interest free product which is Safe keeping, it doesn't represent the generalized challenges and prospect in Ethiopia.

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

Recent study on challenges on interest free banking services in Commercial Bank of Ethiopia by Kerima, (2016) show that utilization of the existing IFB products have been challenged by

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

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

### **1.3. Objectives of the Study**

#### **1.3.1. General objective**

The general objective of the study is to determine the challenges and opportunity of interest free banking in Ethiopia, in the case of Abyssinian bank S.C.

#### **1.3.2. Specific Objectives**

The specific objectives of the project study are as follows:

To assess the current status of interest free Banking services in Ethiopia in the case of Bank of Abyssinia.

To describe the opportunities of interest-free banking has in Bank of Abyssinia Addis Ababa, Ethiopia.

To describe the challenges that Bank of Abyssinia and its customers could face in delivering interest free Banking services.

### **1.4. Research Questions**

The study attempts to answer the following research questions.

- ✓ What is the current status of interest free Islamic Banking services in Ethiopia in the case of Bank of Abyssinia?
- ✓ What are the opportunities to start and rendering interest free banking system in Bank of Abyssinia in Addis Ababa, Ethiopia?
- ✓ What are the challenges to start and rendering interest free banking in Abyssinia Bank S.C in Addis Ababa, Ethiopia?

### **1.5. Significance of the study**

This study addressed the opportunities and challenges of interest free banking service from perspective of the service providers. Therefore, it is anticipated that this study would close that informational gap by providing firsthand data on such a significant subject.

The findings of the study had theoretical and practical contributions. Theoretically, the findings of this study fills an important gap to serve as a reference material to the existing body of the literature and initiate other interested researchers as a starting point to carry out more extensive studies in the area. Additionally, the study's findings would be helpful by presenting case-specific bits of information about the likely circumstances experienced by Ethiopian Islamic Banks that are providing full-fledged interest-free banking services.

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

This study conducted on the challenges and opportunities of interest free banking industry in Ethiopia context. Moreover, the study area is limited to bank of Abyssinia Addis Ketema sub city. Further, the study included only staff member and those have direct contact to interest free banking service in bank of Abyssinia and the study did not include customer of interest free banking business in bank of Abyssinia Addis Ketema sub city

### **1.7. Limitations of the study**

The finding of the study will provide invaluable insights in to challenges and opportunities of interest free baking system in Ethiopia but the present study, study area is limited to Abyssinia bank S.C and branches which are located Addis Ababa city.

### **1.8. Organization of the Thesis**

This research was organized into five chapters. Chapter one contains background of the study, statement of the problem, research objectives, significance of the study, limitations and scope of the study. Chapter two contains review of related literature about the topic of study. Chapter three discuss the methodology employed in this study, including, research design, sample size and sampling technique, data source and collection method, procedure of data collection and method of data analysis. Chapter four include data analysis and discussion of results. Finally, chapter five contains summary, conclusions and recommendations

## **CHAPTER TWO**

### **2. LITERATURE REVIEW**

This chapter analyzes and discusses the relevant literature. It presents the body of research on the opportunities and challenges of establishing Islamic banking in Ethiopia and other nations. This chapter's subsequent sections analyze the pertinent literature in relation to the history of banking in Ethiopia, the definition and classification of *riba* (interest), the justification for the prohibition of interest, the literature and practice of Islamic banking, and empirical data regarding the establishment of Islamic banking in Ethiopia.

#### **2.1. Introduction**

##### **2.1.1. Banking History in Ethiopia**

Emperor Minilik II and Mr. Gill signed an agreement in 1905 that allowed the introduction of modern Banking in Ethiopia. Following the agreement, the Emperor created the First Bank, the On February 16, 1906, The Bank was totally managed by the Egyptian National Bank, within the first fifteen years of its operation, the Bank of Abyssinia opened branches in different areas of the country. In 1906, a branch was established in Harar, in Eastern Ethiopia, at the same time as the Bank of Abyssinia was established in Addis Abeba. A second one was opened in Dire Dawa two years later, as well as at Gore in 1912, at Dessie, and in Djibouti in 1920. The Bank of Egypt's envoy and negotiator at the time, Mac Gillivray, was chosen to lead the new bank as its governor.

From 1919 until the Bank's collapse in 1931, he was replaced as governor by H Goldie, Miles Backhouse, and CS Collier. (NBE, 2001). In January 1964, the Ethiopian National Bank was established with more authority and responsibilities. The Commercial Bank of Ethiopia took over the commercial Banking activities of the old State Bank of Ethiopia after its merger as a share company on December 16, 1963, as per decree No.207/1955 of October 1963. With a capital of Eth. Birr 20 million, it began operations on January 1, 1964. Unlike the prior State Bank of Ethiopia, the new Commercial Bank of Ethiopia employed only Ethiopians (NBE, 2008).

Addis Ababa Bank, Banco di Roma, and Banco di Napoli are three privately held banks merged in 1976 to become Addis Bank, the second-largest bank in Ethiopia, with a capital of Eth. Birr 20 million, 480 employees, and 34 branches. Prior to the merger, these Banks' foreign ownership was initially nationalized in early 1975. By Proclamation No. 99 of 1976, the Agricultural and Industrial Bank, which had been founded in 1970 with 100 percent state ownership, came under the control of the National Bank of Ethiopia.

The Agricultural and Industrial Development Bank was subsequently reestablished by proclamation No. 158 of 1979 as a public finance organization with legal personality. Its responsibility is to finance the growth of the agricultural, industrial, and other sectors of the national economy by providing medium- and long-term loans as well as short-term loans for agricultural output. (NBE, 2001).

The regulatory framework for banking investment was established by the Monetary and Banking Proclamation No. 83/1994 and the Licensing and Supervision of Banking Business No. 84/1994. As a consequence, 486 owners founded Awash International Bank, the country's first private bank, in 1994. By 1998, the bank's authorized capital had reached Birr 50.0 million. On September 20, 1995, Dashen Bank was established as a share corporation with Birr 50.0 million in authorized and subscribed capital. Bank of Abyssinia, another private bank, was founded by 131 owners with subscribed and authorized capital of \$25,000,000 and \$50,000,000, respectively. In 1997, Wegagan Bank began operations with birr 60.0 million in authorized capital. The fifth private bank is United Bank.

## **2.2. Conceptual review of literature**

### **2.2.1. Concepts of interest free banking (Islamic Banking)**

Many scholars' gives 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. ([www.islamic-banking.com](http://www.islamic-banking.com)).

According to Yahiya Abdul-Rahman, (2010), Islamic banking defined as conventional banking minus the word interest with a new contract that does not include the word interest and that is structured in a convoluted version of buy/sell, in which the seller changes ownership to the bank and then the bank sells it to the eventual buyer. Many participants in Islamic banking business thought, with good intentions, that these guidelines made the contract Islamic

## **2.2.2. Definition of terms in Islamic Banking**

### **Interest (Riba)**

Interest is the component in the banking concept. According to Mohammed and Mahdi, (2010) interest is one of the most effective factors for deciding to deposit in banking system. Herald and Heiko, (2009) also mentioned interest as one of the determining factor for commercial bank deposit and it is important element of Islamic economic society. All covers the meaning to load additional money on funds lent to borrower. As such it is fundamental to understand the Islamic economics to have fair idea about Islamic banking.

### **Sources of Funds for Islamic banks**

The institution of Islamic banking forms a cornerstone required to create an Islamic financial environment. Islamic banking plays a vital role in the economic development of Islamic societies by facilitating the mobilization and allocation of dormant savings, which used to be intentionally kept out of interest-based financial channels. Islamic banking institutions utilize various mechanisms for mobilizing funds from the general public, depending on the institution's organization, geographic location, market strategy, capital resources and charter. (Delwin A. Roy, 1991)

### **Current accounts**

The current account is a deposit account that can be used for business or personal purpose and like a saving account. Account holders are not guaranteed and return for keeping their funds with the bank, but they may be rewarded a gift. The primary distinction between current account and saving account is that the minimum balance limits and withdrawals are more

flexible for current accounts. Bala et.al, (2009) In addition to this according to Haron& Wan-Azmi, (2008) current accounts also known as checking accounts, meaning cheque is used to make several type of payments. Current accounts are demand deposit accounts kept with the bank on custodial arrangements and are repayable in full on demand. Current accounts are based on the principle of wadia (trust or safe keeping) or amanah (trust), creating an agency contract for the purpose of protecting and safekeeping the depositor's assets. (Iqbal and Mirkahor, 2011)

### **Investment account deposits**

According to Tabir, Investment deposits represent the case when owners of the fund seek a return on their funds and are willing to spare these funds for an agreed period. These accounts also operate on the principle of mudarabah, but the modes of investment of the funds and distribution of the profits are customized to suit the needs of the clients. In general, these accounts are linked to special investment opportunities identified by the bank. These opportunities have a specific size and maturity and result from the bank's participation in a pool of investment, private equity, joint venture or a fund. (Iqbal and Mirkahor, 2011)

### **Uses of Financial resources in Islamic Banking**

Financial intermediation is the major function of modern banking system. Financial intermediation means taking funds from people who have more than they need at this juncture in time and providing those funds to persons who need them for their economic transactions and activities. (Hassen and Lewis, 2007)

According to Yahiya Abdurahman, (2010) Islamic banking pays close attention as to whom and what to finance. Islamic banks (IFB) do not, for example, finance alcohol- and gambling-related businesses, such as liquor stores or gambling casinos. It also does not finance environmentally irresponsible companies and businesses that are not fair to their employees.

In order to have a comprehensive understanding of the situation surrounding the current IFB directive the analysis will include:

An assessment of the legal framework of IFB windows

An understanding of the level of knowledge and skills among Ethiopian banking industry professional

An evaluation of the level of public awareness of IFB products within the Ethiopian market

### **Legal framework – current practices within IFB windows**

Due to the inexistence of relevant legislation, each bank has adopted their own methodology, models and benchmarks for launching IFB products with little coherence or commonality in the market.

There are two international regulatory bodies in the Islamic finance industry, which have been widely used as standard setting bodies and benchmarks for Islamic and IFB products: the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and International Financial Services Board (IFSB). Appendix 2, details the role of these institutions and how they have been adopted in other countries.

#### Capacity building/Training (knowledge sharing)

Skilled professionals are in short supply in the Islamic finance industry especially in Ethiopia. With IFB being relatively new, only a limited number of initiatives have been undertaken. Amongst these Mercy Corps has sponsored exposure trips to Sudan and the United Arab Emirates to help educate the industry players on IFB. There is a need for sustainable and continuous capacity building initiatives, which allows the on-going development of professionals in this sector. Capacity building is at the heart of the successful implementation and outreach of IFB products. Currently circa 400 branches offer IFB products. Assuming that at least 5 employees per branch need to have IFB expertise, there is a demand for about 2,000-banking officers to have adequate IFB skills in the next 12 months.

Furthermore, according to article 6.4 of the Ethiopian Licensing and Supervision of banking/insurance/micro financing business directive: A bank should “give training to directors at least once in a year on areas of financial analysis, corporate governance, applicable laws, regulations and directives, risk management and internal control.” And the bank “shall file certificate of training of directors with National Bank.” At the moment, there is no mention of IFB training for those banks with an IFB window or any reference to who should be allowed to deliver these courses (such as internationally accredited institutes or locally recognized training companies).

### **Public awareness**

No awareness programs exist to reach out to the Muslim communities in Ethiopia. Prior to the launch of IFB, customers that did not want to receive interest on their savings would sign a waiver to the banks because of their religious beliefs. The fact that monies are deposited in accounts where clients waived their rights to receive interest does not mean that their deposits were now Sharia-compliant. Since there was nothing to state their funds were not used for financing projects on an interest basis and/or projects that contradict with Islamic principles. For instance, the bank may use these monies to provide loans on an interest basis for a project in the alcohol business.

All three banks with IFB windows stated that clients who have signed the waiver for their conventional banking account have not yet asked the banks to switch their monies to an IFB saving accounts. There is no data that explains why this might be the case. The IFB windows believe that some clients may not be aware that these products exist. None of the banks have formally informed their clients of the existence of IFB and none of the 3 IFB windows have undertaken any campaigns to drive awareness among their current or potential clients.

**Growing demand for IFB products:** Given the sizable Muslim population in Ethiopia, there is a need for adequate banking products to serve this segment of the population.

**Lack of benchmark and framework for IFB products:** The current IFB directive does not refer to any benchmarks or frameworks that need to be adopted by financial institutions offering IFB products. The main concern is that the lack of convention for IFB products creates a risk that the products currently offered by IFB windows do not comply with Islamic principles. Therefore, there is a need to standardize the IFB activities and products offered in the Ethiopian market.

**Lack of Sharia Supervisory board:** Having an adequate Sharia Advisory board guarantees a product is compliant with Sharia principles. In Ethiopia, no directive, guidelines or authority supervises and authenticates the Sharia validity of an IFB product. The lack of authority leaves the consumer at risk of not being offered genuine Islamic financial products. Therefore there is a need to address how IFB products can be controlled at the product development stage but also monitored on a regular basis to ensure that they continuously comply with Sharia principles.

**Issues with other legislations and directives:** In some cases conventional legislations and directives are in direct conflict with prospective IFB products offerings. These conflicts may cause IFB products to be less competitive or in some cases make it impossible for IFB windows to launch certain IFB products unless revisions are made to cater for these products.

**Ownership:** According to Article 3 of business directive SBB/12/1996, “A bank may hold shares in a non-banking business only up to 20% of the company’s share capital and total holdings in such business shall not exceed 10%”. This article creates a conflict for issuing Mishawaka or a Mudaraba partnership agreement in which a bank could own up to 100% of a business/transaction at the time of the signing of the contract.

**VAT on commodities: Commodity** Murabaha transactions require that the bank buys and sells commodities for transactions. Intention behind the purchase of the commodity is not to own and use the commodity. Instead, the commodity is sold instantaneously in order to obtain cash. For instance an IFB saving account may offer returns based on the selling of commodities as an underlying asset transaction. In Ethiopia, the selling of commodities is subject to VAT.

**Double taxation:** In a Murabaha transaction, a product or an asset is bought by the bank and sold back to the client at a mark-up price. This poses a double taxation issue for these products or assets.

The above list is not exhaustive. There is a need to vet all the legislation and directives that are directly or indirectly related to IFB in order to come up with a full list of conflicts that will arise when launching new product ranges for IFB.

**Product line:** Current legislation issues limit Sharia based products that are feasible to offer to Muslim population.

**Manuals and procedures:** IFB is relatively new, there is a need to ensure that the manual and procedure for implementing IFB products are designed in such a way that they really comply with Sharia principles. Having reviewed some of the manuals of existing IFB windows, there is a clear need for detailed vetting of these documents.

**Capacity Building:** Currently, capacity building is mainly done on an individual institution basis. The 3 banks have confirmed that the trainings are done internally by staff members that

mainly consisted of self-study to develop the material presented to the branch level staff. The transfer of knowledge is currently limited to the individual interpretation by these banks. Moreover there is no certainty that the sources used for developing the internal training material are accurate and complete. Because of the lack of Islamic financial expertise in Ethiopia there might be a challenge to find adequate trainers with local knowledge and language skills. Capacity building initiatives, education and trainings in Ethiopia can be developed to ensure correct expertise and knowledge is disseminated into the Ethiopian financial market.

**Awareness:** In the previous section we have identified that there is a lack of awareness of IFB product among Muslim communities in Ethiopia. It is essential to reach out and educate the community about IFB product and also to explain that “IFB” does not mean, “free of charge”.

### **2.2.3. Interest free banking in different regions**

#### **In some African countries**

##### **South Africa**

The Muslim population in South Africa is relatively small but both affluent and influential. Interest free bank was introduced in South Africa in 1989 by Alabama Antioch bank operating with a limited branch foot print. This only interest free offering until 2002 when first national bank in the country launched an interest free finance product followed by an interest free cheque account most recently interest free banking started offering its service compliant products through its branch in Botswana in 2006, Absa the largest retail bank including group in south Africa launched, the first comprehensive interest free bank offering the services like cheque account vehicle finance, transactional saving account and interest free wills. This offering was supported by the full range access support from the ATM and branch network in the country, as well as sale phones and internet banking (<http://www.financeinIslam.com> ).

##### **Nigeria**

Nigeria with population of 140,000,000 people is not only the most populous country in Africa but it is also the largest economy in West Africa 60 percent of Nigerian Muslims and in response to their demands to have a bank that meets their religious moral and ethical aspirations the efforts are in progress by a number of corporate bodies, individuals and Islamic

organization to achieve these goal and with their regulatory frame work of interest free banking by the central bank of Nigeria in feb.2009,all is now set for jazz, the first interest free bank in Nigeria to commence full commercial operation (<http://www.financeinIslam.com> ).

### **In some Arab counties**

#### **Iran**

The processes of transformation of interest free banking in Iran have proceeded in the three distinct phases. Nationalization, restructuring and re-organization of entire banking system characterized phase one taking Place between 1979 and 1982. External and internal developments did not allow the policy makers to develop coherent plan for interest free banking system although various piecemeal attempts were made towards this objectives. The second phase began in 1986, it was a phase primarily characterized by adoption of legislative and administrative steps in order to implement a clear articulated model of interest free banking. The third phase which continues until now, began in 1996. This phase define the role of interest free banking system differently from the earlier phases. The banking sector has been used an instrument to restrict Iranian economy. The restriction was essentially direct the shifting financial resources from services and consumption to the production sector in four ways. First, credit to service sectors. Second, it creates incentive for the development of cooperative sector planning in agriculture, industry and trade. Third, the banking system in partnership with the government under takes to finance large industrial projects and investment in social overhead capital. Fourth, using all available model of finance to help farmers to improve and expand production encourages growth of the agriculture sector. (<http://www.financeinislam.com> )

#### **Pakistan**

Pakistan adopted a policy of gradual transformation of its banking system from February 1979, after several years of study and preparation by the government appointed Council of ideology. The process started when the president of Pakistan announced that interest was to be removed from the economy with in a period of 3 years. In June 1984 the government announced discontinuation of dual window of operation on the banking and financial system, except the foreign currency deposit which continue to earn fixed interest, where brought under non interest based modes of financing. Interest free banking in Pakistan appears to be cross

road and if there to be further progress the regulatory and legal condition must be such that system will have a fair chance to perform as expected (<http://www.finance.in.Islam.com> ).

### **In Ethiopia**

In Ethiopia, OIB has opted to follow AAOIFI and both NBE and OIB have undertaken discussions with the IFSB on the possibility of implementing their standards at a national or institutional level. CBE looked into the UK, South African and Bahrain to develop their IFB product offering whereas; United Bank has based their products on Pakistan and Saudi Arabia. The above shows that the directive seems to be simplistic and leaves too much room for offering products that may not be aligned with the actual Ethiopian needs.

In their current state, IFB windows do not fully and effectively adhere to Islamic principles. Article 2.2 of the Ethiopian IFB directive states that IFB business “refers to banking business in which mobilizing or advancing funds is undertaken in a manner consistent with Islamic finance principles. Hence, in order to achieve Sharia compliance, IFB windows need to have an extra layer of governance to ensure that the principles outlined in the latter article are met.

In Ethiopia, NBE does not currently have internal experts to review and monitor IFB windows to make sure that they comply with article 2.2. On the institutional level, only OIB has opted for a Sharia Supervisory Board (SSB) model. The later is composed of 3 scholars two of whom have been drawn from the Ethiopian Islamic Affairs Supreme Council. In short, the Ethiopian Islamic Affairs Supreme Council has sound knowledge in Sharia law but lacks depth in financial expertise.

So far CBE and United Bank have not sought any Islamic expert advice to develop their Interest Free product offerings; instead they have relied on Internet desk research. These banks do not currently have any Sharia board or Sharia advisors. Nevertheless, United Bank intends to have an advisory board for “Sharia compliance” that will be composed of financial advisers rather than Sharia scholars, as it prefers to distance itself from the Ethiopian Islamic Affairs Supreme Council, thus avoiding affiliation with a specific stream of Islamic viewpoints. In time, these measures may reveal that relying purely on Internet desk research along with independent financial advisers may conversely affect their decision-making aptitudes in regards to Islamic finance frameworks. The lack of regulatory framework on the

Sharia compliance question means that the products are at high risk of not complying with authentic Islamic principles.

### **2.3. Empirical literature review**

As interest free banking is the recent phenomena different researchers internationally try to see this topic in different ways. Rodney Wilson, (2010) indicated that interest free banking finance has become increasingly significant in financial centers in the West, notably London, despite the regulatory hurdles presented by operating in a non-Muslim financial environment. At the same time interest free financing methods are viewed as a challenge and opportunity by Western bankers, many of whom have sought to get involved in this growing industry. In client driven societies there is willingness by those in financial services to listen and learn from the experiences of interest free banks, which in the longer run may bring a major breakthrough for interest free banking at the retail level in the West (Rodney Wilson, (2010).

Hanudin Amin, (2013) in his article of some view points of interest free banking retail deposit products in Malaysia indicated that those products were centered on the current accounts, saving accounts and investment accounts. These deposit products are examined in terms of their definitions, features and calculations. On the same note, some discrepancies between deposit facilities offered by interest free and conventional banks are exposed. The purpose of such exposition was to provide to novice readers a basic but profound explanation concerning the difference between the two categories of deposit facilities.

Abdulmajid et.al (2015) conducted research on the efficiency in interest free banking and conventional banking an international comparison investigates the efficiency of interest free banks and conventional banks using an output distance approach. Even after controlling for specific environmental characteristics both interest free and conventional banks, interest free banks are found to have high returns to scale than conventional banks. While this suggests that interest free banks may benefit from increased scale, they emphasis and the results suggest that identifying and overcoming the factors that cause interest free banks to have relatively low potential output for a given input usage levels will be the key challenges for Islamic banking in the coming decades Abdulmajid et.al (2015).

According to Ismaeil, et al. (2015) conducted a research on Islamic banks (interest free banking) as alternative banking industries. The result showed the recent development of

insolvency of many conventional banks made by the Central Banks to initiate the acquisition of some banks while others were ordered to merge. This was a strong signal to seek for alternative banking system. However, the advocacy for the Islamic banking system as alternative to conventional banking system has been received with mixed feelings. He also posited that awareness, manpower, legal framework, societal belief, cash requirements were some of the challenges while economic growth, attraction of investors, and fostering of egalitarian society are the likely prospects for the establishment of the interest free banking. He concluded that interest free banking system hold a potential to transform all sectors of the economy with eradication of poverty, equitable distribution of income and employment opportunities in the country through effective mobilization and allocation of capital (Ismaeil, et al. (2015).

### **Empirical Literature in the Ethiopian Context**

According to the Economist Intelligence entity study (2015), Africa is the world's largest untapped growth market for "Islamic" commerce (Banking, insurance, bonds, and 20 capital markets) and halal food (sharia-compliant goods and services). Islam, along with Christianity, is the most popular religion in Sub-Saharan Africa, with 67 percent of Muslims. Ethiopia, a sub-Saharan country, is another potential customer for IFB

In order to permit conventional banks to undertake interest-free banking, the NBE published "Directives to Authorize the Business of Interest-Free Banking No. 1" in 2011. According to the Directive, banks applying for a license to offer interest-free banking services must adhere to Islamic financial principles and standard operating procedures in addition to other formal criteria. IFB is still a relatively new phenomenon in Ethiopia. According to the researcher, there doesn't seem to be any research on the possibilities and difficulties of interest-free banking in Ethiopia.

In Ethiopia, Interest free banking is a recent phenomenon. As a result, there is limited empirical literature on the area. The studies conducted so far include the following: Akmel Hailu's (2015) studied about "challenges and prospects of Islamic banking for resource mobilization in Ethiopian commercial banks. "The study focuses on challenges and opportunities of IFB only on resource mobilization other challenges and opportunities are not well addressed.

On the other hand a research by DebebeAlemu (2015) who studied the factors affecting customers' use of IFB in Ethiopia and found out that 100% of IFB account holders were all Muslims. Evidently, the failure of banks to meritoriously serve the Ethiopian Muslim population hinders the development of the Muslim inhabited areas in particular and the economy of the nation as a whole. This study is about impact assessment on the attitude towards IFB usage which does not address the current problem at hand. Mohammed's (2012) study which is about "Challenges on Interest Free Banking Services" The study discuss the challenge faced by service providers and users of IFB products and scope of service provided by Ethiopian banking through IFB including whether there is unmet demand of users, awareness of customers and capacity of bank .the study doesn't addressed the opportunities of interest free banking as a new business strategy in Ethiopia.

Tsionsisay (2017) conducted research on challenges and opportunities of interest free banking in case of commercial banks operating in Addis Ababa. The result of this study stated that lack of awareness by customers and difficulty to segregate fund for effective implementation of IFB service. The researcher concludes that the opportunities of interest free banking are more significant than the challenges.

On the other hand Yewubedar Getachew (2018) also conducted research on challenges and opportunities of interest free banking in case of commercial bank of Ethiopia northern district. The research concludes that lack of sheriah advisors boards, lack of awareness of customers regarding interest free banking, Lack of confidence by customers, unavailability of the service in all branches are challenges of interest free banking operation. In addition RobelDemissie (2019) conducted a research on factors affecting implementation of interest free banking service in Ethiopia: the mediation role of customer involvement. The result of this research showed that awareness, comparability, complexity, observability, perceived risk; religious beliefs and customers involvement were significant on the implementation of interest free banking service

## 2.4. Conceptual framework

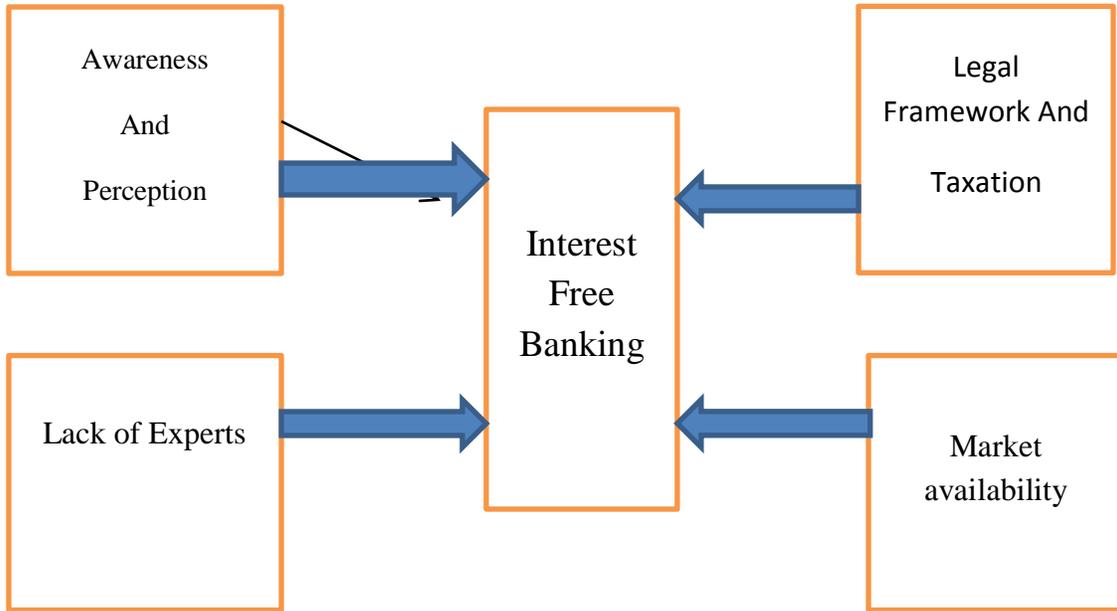


Figure 2.4.1; - Conceptual framework of challenge and opportunities on interest free banking

# CHAPTER THREE

## 3. RESEARCH METHODOLOGY

### 3.1. Study area and period

The present-day Bank of Abyssinia was established on February 15, 1996 (90 years to the day after the first but defunct private bank was established in 1906 during Emperor Menelik II) in accordance with 1960 Ethiopian commercial code and the Licensing and Supervision of Banking Business Proclamation No. 84/1994. BOA started its operation with an authorized and paid up capital of Birr 50 million, and Birr 17.8 million respectively, and with only 131 shareholders and 32 staff. In two decades since its establishment, Bank of Abyssinia has registered a significant growth in paid up capital and total asset. It also attracted many professional staff members, valuable shareholders and large customers from all walks of life. This performance indicates public confidence in the Bank and reliability and satisfaction in its services. Operators like Western Union, Money Gram, Express Money, Dahabshiil, TransFast, Ria, World Remit & Kaah (Haregeweyn, 2022). The study was conducted from Aug.2024 up to Dec 2024.

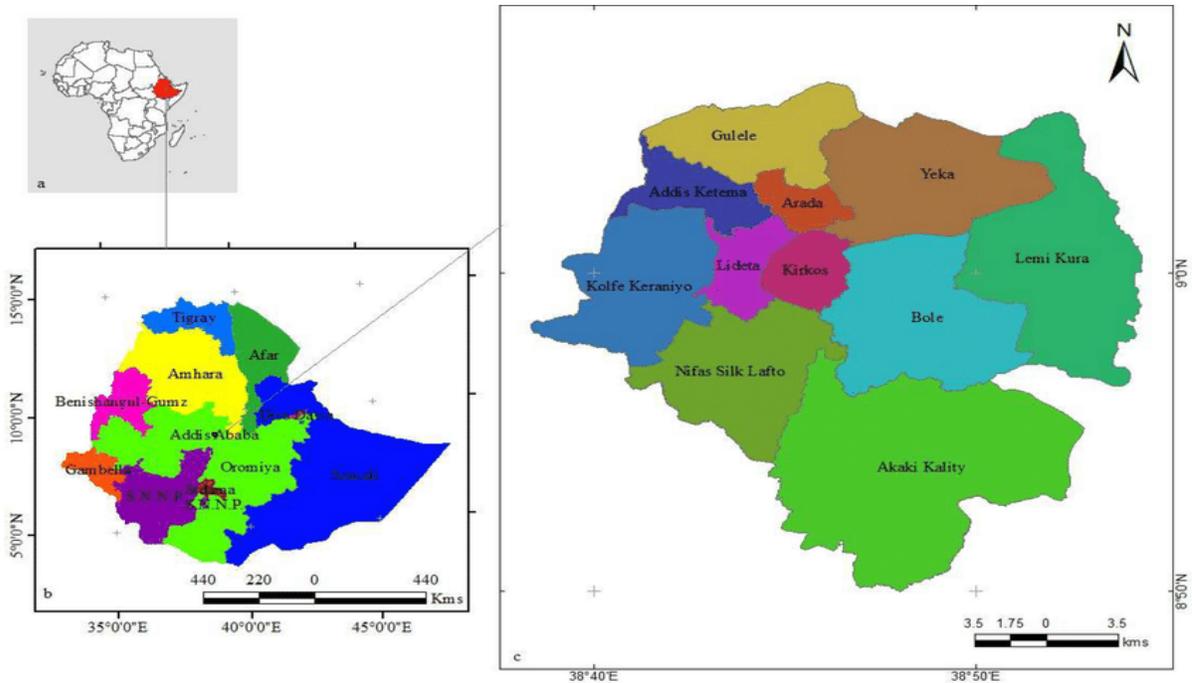


Figure 3.1.1; - Map of Addis Ababa, with sub-cities Source: Ethio GIS (2022)

### **3.2. Research Design and approach**

The research used a mixed type study approach. A mixed-methods research approach is a type of research methodology that combines both qualitative and quantitative research techniques, methods, approaches, and data in a single study. This approach allows researchers to gain a more comprehensive understanding of the research problem by using the strengths of both qualitative and quantitative methods.

The research design applied in this study was descriptive. This descriptive research design provides a structured approach for exploring the challenges and opportunities of interest-free banking, and for identifying effective policies and practices for its implementation. In actuality, the research design serves as the conceptual framework for the study and serves as the manual for data collecting, measurement, and analysis.

### **3.3. Data Type and Source**

Both primary and secondary data were used to conduct this study. The primary data were collected from managers, officers, and directors of Abyssinia Bank included in the study.

A primary data were collected by using of fully structured questionnaire. A questionnaire was used to gather the primary data for the study from selected samples in order to elicit perspectives on the challenges and opportunities of internet free banking. It comprises of a number of questions in print or nature in a certain sequence on a form of closed-ended questions and also by interview based questions to get detail information on challenge and opportunity on interest free banking in bank of Abyssinia.

### **3.4. Data Collection method and Technique**

The research was used fully structured questionnaires for quantitative study and interview based questions for qualitative study. The survey asked structured questions that used five different evaluation techniques (Strongly disagree, Disagree, Neutral, Agree, and strongly agree). The officers, directors, founders and managers of Abyssinian Bank S.C are the targeted groups for questionnaires and interviews that gathered the primary data. Both open-ended and closed-ended questions are asked during the interview and on the questionnaire. For the secondary data, the researcher used printed papers from the target Bank, NBE guidelines for IFB operation, and other people's studies. The first of the questionnaire's four sections deals

with the demographics of the respondents. Part two, which was expected, assesses the challenges and opportunities of Interest free banking in Ethiopia, customers or employee need for interest-free Banking services, In part three, the researcher applied an open-ended interview questionnaire to investigate more about challenges and opportunity on interest free banking services.

### **3.5. Source and study population**

The study population encompasses all managers, officers, and employees directly connected with interest free banking and willing to participating in the study.

### **3.6. Sample size determination**

The sample size of the respondents was determined by using sample determination formula developed by Yemane (1967)

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

Where: Confidence interval 95% and the error 0.05 or 5%

Number of study population N=150 (Source, BOA)

Confidence interval = 95%

Error= 5 % or 0.05

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

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

$$n = 109$$

### **3.7. Sampling Technique**

The board members and employees those are directly related to interest free banking service were sampled using a stratified methodology. However, convenience sampling was used for selecting study participant and it is one of the non-probability sampling techniques that is immediate, cost effective, and quick. Instead of choosing from the entire population, researchers can use whoever is available and cooperative. This is not because such samples are inherently simpler to use. So a total of 109 study participant was selected from 17 branches of bank of Abyssinia proportionally by convenience sampling techniques. Bank of Abyssinia has

a total of 38 branches in Addis Ketema sub-city, Addis Ababa including sub-branches. Mr. managers of operation inform that there are 17 branches and 21 sub-branches with 150 employees including branch managers and operation supervisor those has direct relation with interest free banking. The following table is a list of branches and number of study participants those are selected on convenience sampling techniques

R.n	Branches	No of participants	
1	Abba Koran branch	6	
2	Addisu Michel branch	6	
3	Addis ketema branch	6	
4	American Gibi branch	6	
5	Atenatera branch	6	
6	Awtobis Tera branch	6	
7	Amana branch	10	
8	Babel-Araaq branch	9	
9	Bomb tera branch	6	
10	Biret tera branch	6	
11	Cinema Ras branch	6	
12	Dj. Omour Semeter branch	6	
13	Minalesh tera branch	6	
14	St.Raguel branch	6	
15	Sebategna branch	6	
15	Kolfe branch	6	
17	Mesalemiya branch	6	

### **3.8. Data quality management**

Pretest: the questionnaire was pre-tested on 5% of the total estimated sample before the actual data collection on purposely selected one private bank from those selected study area for clarity and completeness. .

Data checking and cleaning: IBM SPSS 28 statistical software was used to clean and check data files for missing and illegal values

### **3.9. Data Analysis Methods**

Data was first entered in to IBM SPSS (versions 28) for cleaning and analysis. The majority of the descriptive statistics were percentiles of the distributions of the participants' responses. The researcher analyzed the responses to the research questions quantitatively and qualitatively. The findings were presented using tabular and charted figures to describe the intended meaning and make it easier to grasp the research findings.

Interview qualitative data obtained by taking written notes during the interview and providing raw materials for the report in the form of video and sound recordings of what is said. The analysis consolidated and conveyed the information provided by the informant by using a narrative technique to relate it to the study's major objectives. Qualitative analysis, on the other hand, will triangulate some of the replies collected through closed-ended questions.

### **3.10. Ethical consideration**

An ethical clearance for the study was received from St Marry University, department of project management, research ethical review committee. A formal letter was submitted to bank of Abyssinia head office to conducting the data collection. Informed, voluntary, verbal consent was sought from each participant by using of participant information sheet and confidentiality was guaranteed.

## CHAPTER FOUR

### 4. RESULT PRESENTATION

#### Response rate

In this study out of the total sample size, which is 109 managers, supervisory and employees directly connected with interest free service, 109 respondents were responded to the questionnaires', this makes 100% respondent rate.

#### 4.1. Demographic characteristics of respondents

Based on the total study participants the majority 69 (63.3%) were Male while 36.7% of the study participants were female. Based on the highest educational attainment of the study participant the majority 68 (62.4%) were degree holder while the remaining 41 (37.6%) of the study participants were masters and above level of education. Based on the religious belief of the study participant the majority 68 (62.4%) were orthodox Christian followed by Muslim which accounts to 23.85%.

Table 4.1.1:- Socio-Economic Status of Respondents

R.n	Characteristics		Frequency	Percentage
1	Gender	Male	69	63.3
		Female	40	36.7
2	Education	Certificate	0	0
		Diploma	0	0
		Degree	68	62.4
		Masters and above	41	37.6
3	Religion	Orthodox	81	74.31
		Muslim	26	23.85
		Protestant	2	1.83
		Other	0	0

Source; processed from survey data

### Working experience

Based on the working experience of the study participant the majority 56 (51.38%) of the study participant had 10 – 20 years of experience followed by respondents having 5 – 10 years of experience which accounts to 24.77%

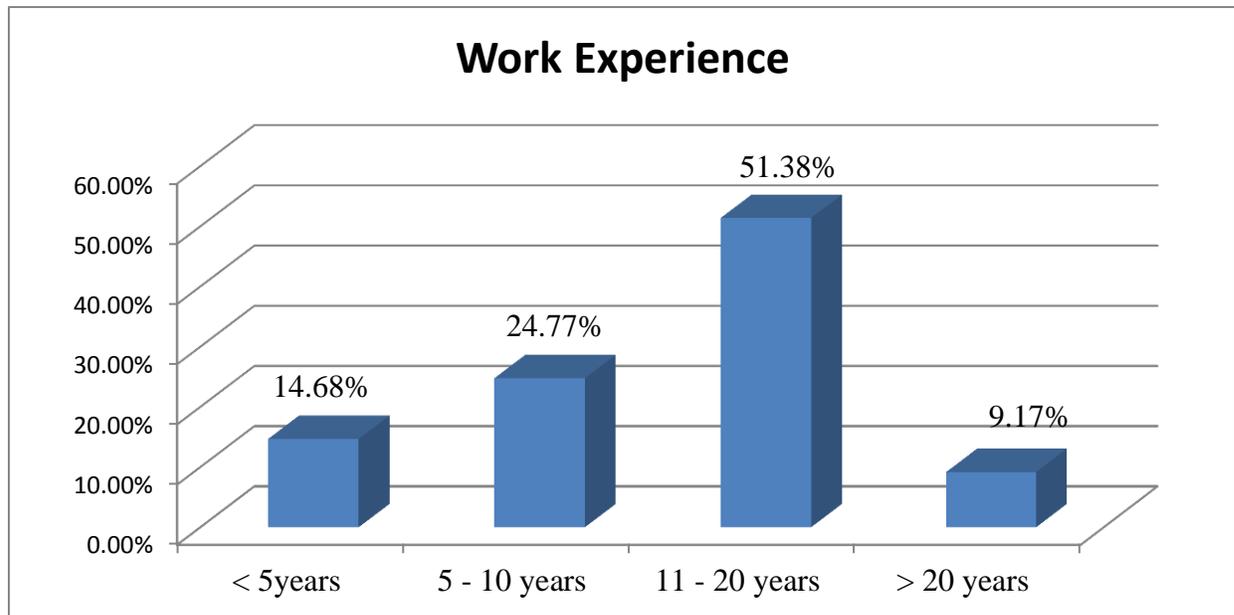


Figure 4.1.3:- Working experience of the study participant

Source; processed from survey data

## 4.2. Challenges of Interest free banking for Bank of Abyssinia

### There is an inadequate regulatory and legal framework

The table shows that the majority 77 (70.64%) of the respondents strongly agreed with inadequate regulatory and legal framework for an interest-free banking system are the challenge of interest free banking and 13 (11.93%) of respondent were agreed with inadequacy of legal frame work were the challenge of interest free banking in bank Abyssinia. The average of the sample's replies was 4.35, which is a clear sign that they understood. This implies that there is an inadequate regulatory and legal framework for interest-free banking system operation in Ethiopia was the challenge of interest free banking.

Most participants of interview questionnaire agreed with inadequate regulatory and legal framework for interest-free banking system operation in Ethiopia was the challenge of interest free banking. One of the participants reported; *the legal frame work and regulatory mechanism of the government and also the government control system on interest free banking is not covenant and sufficient and some of the policies are binding and hinder the improvements of the service from the current level”*.

Table 4.2.2:- Inadequate regulatory and legal framework

Strongly disagree		Disagree		Neutral		Agree		Strongly agree	
5	4.59%	9	8.26%	5	4.59%	13	11.93%	77	70.64%

Source; processed from survey data

### **There is a shortage of expertise for operations**

Respondents were asked if there was a shortage of experienced professionals with interest-free banking operations in Bank of Abyssinia is the challenge of interest free banking. According to the findings, 59.63% and 11.01% of respondents strongly agree and agree with the statement, respectively, while the remaining 22.94% was disagree with the statement. The mean value of the score of the result was 4.03. Strong evidence suggests that there is a shortage of professionals in interest free banking in Ethiopia. This implies that in the Bank of Abyssinia lack of professional expertise was the challenge of interest free banking. The response of the study participant on interview questionnaire also support the finding of the qualitative study one respondent told that” *Our bank has made little effort in terms of providing various trainings and facilitating educational opportunities in order to increase the professional's awareness of interest-free banking services and to create qualified professionals. Therefore, the awareness of the professional in terms of improving and updating the service is low.*”

Table 4.2.3; - Shortage of expertise for interest free banking operations

Strongly disagree		Disagree		Neutral		Agree		Strongly agree	
4	3.67%	21	19.27%	7	6.42%	12	11.01%	65	59.63%

Source; processed from survey data

**There is a misperception of interest free banking**

To determine whether respondents believed that consumer and other parties had a clear understanding of Interest Free Banking products and services. The majority 77 (70.64%) were strongly agreed and agreed with the perception of the customers is the challenge of interest free banking in bank of Abyssinia. The average for the entire group was 3.67. This implies that there is a misperception of interest free banking products and services from customers and others were the challenge of the interest free banking system in the bank of Abyssinia

Table 4.2.4:-Misperception of I interest free banking products and services

Strongly disagree		Disagree		Neutral		Agree		Strongly agree	
2	1.83%	19	17.43%	20	18.35%	40	36.7%	28	25.69%

Source; processed from survey data

**There is a gap in the research and development of interest free banking**

The table shows that the majority 63 (57.8%) and 21 (19.27%) of the respondents agreed and strongly agreed respectively with gap in the research and development of interest free banking finance and economics. The average for the entire group was 3.79. This implies that gap in the research and development of i interest free banking finance and economics were the challenge for interest-free banking system operation in Ethiopia.

.Table 4.2.5;- Research gap in research and development

Strongly disagree		Disagree		Neutral		Agree		Strongly agree	
5	4.59%	6	5.5%	13	11.93%	63	57.8%	21	19.27%

Source; processed from survey data

In-depth interview revealed on two questions related to challenges and opportunities of interest free banking. The majority of the participants of the study participants mentions the gap of research and development challenges the success and achievements of interest free banking

One of the participants reported; *"I don't saw any bank do any research and development related to interest free banking finance and economics to improve the services and also a did not see a new procedure to improve the service they stick to the previous system"*. Other study participants also told that *"one of the problems we have on this service is that it doesn't pay much attention to this service like other services"*

**Lack of awareness on interest free Banking system**

Based on the response of the respondents on whether Muslim populations are well aware of the interest free banking system, despite the fact that interest free banking operations are mostly focused on Muslims population due to its related to sharia compliance character, the majority 58 (53.2%) were agreed with lack of awareness of the interest free Banking system was the challenge of interest free Banking system. The average for the entire group was 3.56. The findings imply that awareness on interest free banking by the customers is having difficulties on reaching the potential clients due to most of the community has not enough awareness on the interest free Banking system. The response of the study participant on interview questionnaire also support the finding of the qualitative study one respondent told that *" I started working at this bank on this interest-free banking service. From the beginning, the understanding of the customers is little. They only know about the interest-free savings service, but this interest-free service has many services, but the customers who use it are few. It is not seen that the bank is making an effort to solve this problem"* this response also similar to the response of the other respondents so the level of awareness among the customers challenges the growth of the interest free banking

Table 4.2.6; - Lack of awareness on interest free Banking

Strongly disagree		Disagree		Neutral		Agree		Strongly agree	
1	0.92%	29	26.6	4	3.67%	58	53.2%	17	15.6%

Source; processed from survey data

**Taxation issues in relation to interest free Banking products**

The term "double taxation" refers to the tax that Islamic banks would incur as a result of stamp duties that are owed upon the transfer of assets. Customers also pay stamp duties when

ownership of identical products is transferred from the bank to them. Based on burden of taxation challenges on interest free Banking, the majority 47 (43.12%) were agreed with double taxation were the challenge on interest free banking system. The average for the entire group was 3.30. The findings imply that taxation system of the country on interest free banking was the challenge on the success of the banking system.

The response of the study participant on interview questionnaire also support the finding of the qualitative study one respondent told that” *In my opinion, I believe that the government's tax policy on interest-free banking services has become an obstacle to attract more customers. Islamic banks use a variety of financial instruments, such as profit-sharing, leasing, and joint ventures, to generate returns for their investors but the current double tax policy follow the same income is taxed twice, typically when it is earned and when it is distributed as dividends. If this tax policy is improved or changed, more customers can be generated.*” this response also similar to the response of the other respondents so the taxation policy of the country challenges the success of the interest free banking

Table 4.2.7; - Taxation issues in relation to interest free Banking products

Strongly disagree		Disagree		Neutral		Agree		Strongly agree	
4	3.67%	24	22.02%	25	22.94%	47	43.12%	9	8.26%

Source; processed from survey data

### 4.3. Opportunities for Interest free banking in Ethiopia

#### **There is an untapped market for Interest Free Banking products and services**

The findings of the study showed that the majority 72 (66%) of respondents believed that untouched market of the interest free banking in Ethiopia market are an opportunity on the success of interest free banking but 13.76% of study participant are disagree with the statement. The mean value of the score of the result was 4.36. This implies that untapped market for interest free banking is a good opportunity for interest free banking in Ethiopia. The response of the study participant on interview questionnaire mention this issues as an opportunity and also support the finding of the qualitative study, one respondent told that ” *In my opinion, since this interest – free banking service has been launched in our country recently*

and the number of people seeking the service is large, I think there will be an opportunity to generate better customers and the service will be successful in the future.” this response also similar to the response of the other respondents so the untapped market for interest free banking in Ethiopia will be an opportunity success of the interest free banking

Table 4.3.1; - There is an untapped market for interest free banking

Strongly disagree		Disagree		Neutral		Agree		Strongly agree	
2.75%	0	11.01%	12	0	0	20.18%	22	66.06%	72

Source; processed from survey data

### **There is an increasing public interest in interest free banking service**

Based on the perception of the study participant on increase in interest in interest free banking service by customers, the majority 56 (51.38%) of study participant agreed with increase in public interest are a big opportunity for interest free banking in Ethiopia but 29 (26.61%) and 21 (19.27%) of the study participant were disagreed and strongly disagreed with the increasing of public interest in interest free banking service as an opportunity for the success of the banking service. The mean value of the score of the result was 2.92. This implies that increasing of public interest in interest free banking service as an opportunity for the success of the banking service.

Table 4.3.2; - An increasing public interest in interest free banking products and services

Strongly disagree		Disagree		Neutral		Agree		Strongly agree	
19.27%	21	26.61%	29	0	0	51.38%	56	2.75%	3

Source; processed from survey data

### **Interest free banking is a straightforward and adaptable financial system**

In addition, respondents were prompted to share their opinions about Ethiopia's banking sector's adoption of the IFB system. the majority 49 (44.95%) of study participant agreed with increase in public interest are a big opportunity for interest free banking in Ethiopia but 44 (40.37%) and 5 (4.95%) of the study participant were disagreed and strongly disagreed with

the Interest free banking is a straightforward and adaptable financial system as an opportunity for the success of the banking service. The mean value of the score of the result was 2.26. This implies that Interest free banking adaptability of the banking system on financial market are an opportunity for the success of the banking service. So interest free banking are straightforward and adaptable financial system

Table 4.3.3; - Islamic banking is a straightforward and adaptable financial system

Strongly disagree		Disagree		Neutral		Agree		Strongly agree	
4.59%	5	40.37%	44	0	0	44.95%	49	10.09%	11

Source; processed from survey data

### **The availability of Interest free banking products**

Respondents were asked if they believed that Interest free banking supported the growth of business and investments. The majority 45 (41.28%) and 30 (27.52%) of the study participant were agree and strongly agree with the availability of interest free banking service and products are a big opportunity for the success of interest free banking in Ethiopia but also a large number of study participant 32 (29.36%) was disagreed with the statement. The sample's average, which was 3.63, indicates that respondents have a propensity to agree with the statement. The result of study findings implies that the availability of interest free banking in Ethiopia is a big opportunity for the success of interest free banking. So, the availability of Islamic banking products (savings and loan services) will encourage business expansion and investment.

Table 4.3.4:- The availability of Islamic banking products (savings and loan services) will encourage business expansion and investment

Strongly disagree		Disagree		Neutral		Agree		Strongly agree	
2	1.83%	32	29.36%	0	0	45	41.28%	30	27.52%

Source; processed from survey data

**The Interest free banking system potential for boost Ethiopia's economy.**

Based on the perception of the study participant on increase in Interest free banking system potential for boost Ethiopia's economy, the majority 58 (53.24%) of study participant agreed with Interest free banking system has a potential for boost Ethiopia's economy. The mean value of the score of the result was 3.66. This implies that the potential of interest free banking for increase the economy of the country are a big opportunity for the success of interest free banking.

Table 4.3.5; - The Islamic banking system has the potential to boost Ethiopia's economy.

Strongly disagree		Disagree		Neutral		Agree		Strongly agree	
10	9.17%	14	12.84%	3	2.75%	58	53.24%	24	22.02%

Source; processed from survey data

**Other communities besides Muslims are also interested in interest-free banking.**

Based on the respondent believe on community other than Muslim interest on interest free banking are an opportunity for the success of interest free banking in Ethiopia, the majority 42 (38.53%) of the respondents were neutral or no comment on the statement followed by 35 (32.11%) of the respondent was strongly disagreed with the interest of other community beside Muslim are not an opportunity for the success of interest free banking in Ethiopia and only 25 (22.93%) of the study participant agreed and strongly agree with its opportunity. The mean value of the score of the result was 2.89. This implies that the interests of other community other than Muslim on interest free banking are very low. In reality, interest free banking service was mostly focused on Muslim community.

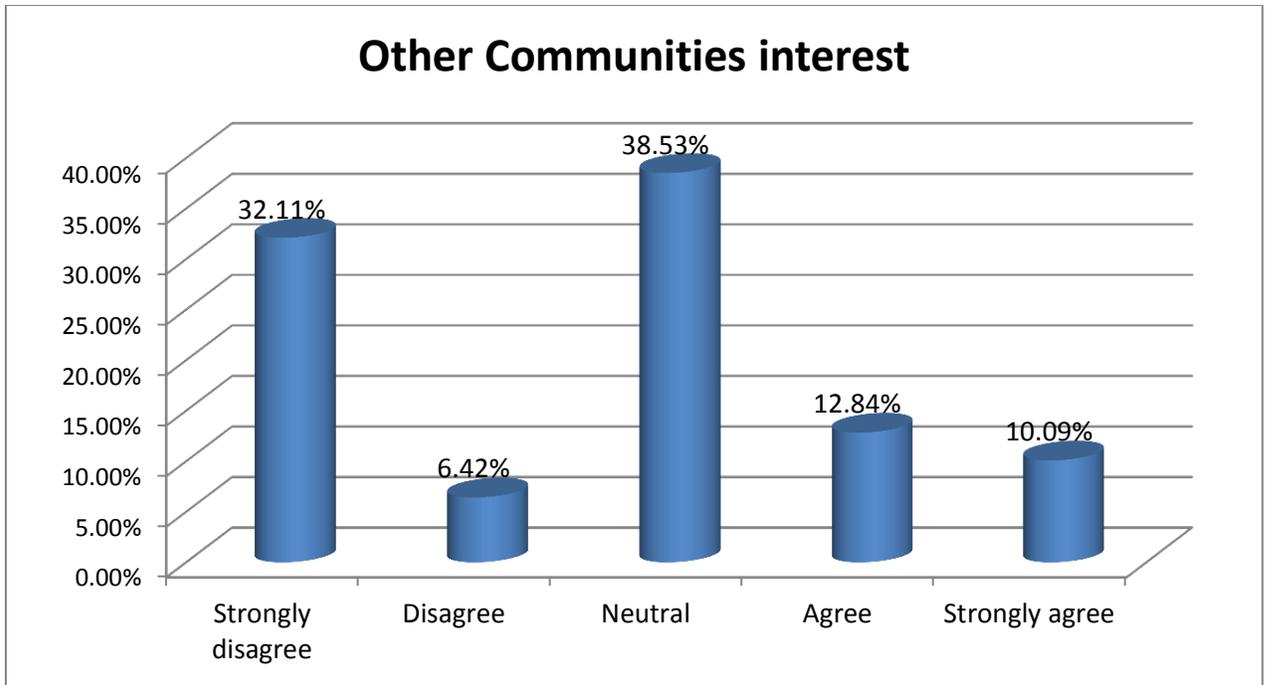


Figure 4.3.1; - Other communities besides Muslims are also interested in interest-free banking

Source; processed from survey data

#### **4.4. Discussion**

The main finding of the study on the state of Interest free banking system showed that the main challenges faced by Bank of Abyssinia were misunderstandings of IFB products, a lack of professional trained expertise on interest free banking, lack of adequate regulatory and legal framework, services from prospective customers, a research gap on interest free banking, lack of awareness from customers and double taxation are the main challenges that face interest free banking. The study also find the main opportunities for interest free banking to increase its service and its success in the Bank of Abyssinia were untouched market for interest free banking products and services, there is growing public interest in interest free banking, the financial system is simple and flexible, and it has the potential to strengthen the nation's economy.

The results of earlier studies on interest-free banking also support the finding of this study. These studies include Tsion (2012), Akmel (2014), and Debebe (2015), which demonstrated that interest free banking in Ethiopia had a significant untapped opportunity to serve millions of Ethiopian Muslims but still needed to address challenges related to a lack of awareness and understanding, legal, supervisory, regulatory, and/or institutional challenge, and a lack of well-trained experts and appropriate banking policies for interest free loans.

The findings of this study provide significant implications for policy makers who are responsible in issuing banking business regulation and for investors who are interested to invest in Islamic Banking sector. Further, this study might be contribute to the literature on Islamic banking in Ethiopia as the newness of the sector and unavailability of adequate literatures. Finally, it will encourage researchers to do more investigations and academic studies on this area.

## **CHAPTER FIVE**

### **5. CONCLUSION AND RECOMMENDATION**

#### **5.1. Summary and conclusion**

The aim of the current research was to analyze the challenges and opportunities of interest-free banking in the context of Bank of Abyssinia S.C. Islamic banking is a financial system that operates in accordance with the principles of Islamic law, which prohibits the charging or paying of interest. Instead, it relies on a system of profit and loss sharing, where the bank and the customer share the risks and rewards of a particular investment or project.

One of the main challenges of Islamic banking is the lack of a clear legal and regulatory framework in many countries, which can make it difficult for banks to operate and for customers to understand the terms and conditions of their accounts. Additionally, the lack of standardization in the industry can make it difficult for banks to compare their products and services with those of their competitors.

Despite these challenges, Islamic banking presents several opportunities for both banks and customers. For banks, it offers the opportunity to differentiate themselves from traditional banks and to attract customers who are looking for a more ethical and socially responsible alternative. For customers, Islamic banking offers the opportunity to invest in projects and assets that are in line with their religious and ethical beliefs, and to avoid the charging of interest, which is considered usury in Islam.

Overall, the challenge and opportunity of Islamic banking lies in its ability to balance the principles of Islamic law with the needs and expectations of modern financial markets. As the industry continues to grow and evolve, it is likely that we will see more clarity and standardization in the legal and regulatory framework, as well as the development of new products and services that meet the needs of customers.

## **5.2. Recommendation**

The following recommendations are made in light of the study's findings:

- ✓ The National Bank of Ethiopia should take some measures related to banking policy on interest-free banking and financing.
- ✓ To solve the problem related to taxation issues (double taxation) on interest free services and products, the Ethiopian federal revenue authority should establish taxation regulations that take into account the taxation of profits from interest-free products and services from the perspectives of both customers and banks.
- ✓ For the Bank to successfully deliver its products and services to its target customers, proper training campaigns for manpower on interest-free banking operations are essential.
- ✓ In order to address the problems, the interest-free banking system faces, responsible entities should do research on the installation and operation of interest-free banking.
- ✓ In order to combat misunderstandings and a lack of understanding about its products and services, Bank of Abyssinia should market its offerings to the general public through the best and most economical methods.
- ✓ In order to reach potential clients and improve public accessibility, Bank of Abyssinia should grow its branch and adopt various digital methods.

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## **Appendices**

### **St. Mary University**

#### **School of Graduate Studies**

#### **Department of Project Management**

Dear Respondents:

My name is Tomas, a Masters student at St. Mary's University School of graduate studies in the Department of Project Management. Currently I am conducting a research that aims at investigating "the Challenges opportunities on Interest Free Banking in the case of Abyssinia bank. The purpose of the study is for the partial fulfillment of the requirement for project management Program. For the successful accomplishment of the study, the response of the study participant will have pivotal role by being used as valuable input for the study. You have been selected purposefully from the working group of interest free services in your branch. 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!

**Part one: socio demographic characteristics of respondents**

<b>R.n</b>	<b>Variables</b>		
<b>1</b>	<b>Age</b>	<u><b>In years</b></u>	
<b>2</b>	<b>Gender</b>	<b>1. Male</b> <b>2. Female</b>	
<b>3</b>	<b>Education</b>	<b>1. Certificate</b> <b>2. Diploma</b> <b>3. Degree</b> <b>4. Masters and above</b>	
<b>4</b>	<b>Years of experience</b>	<u><b>In years</b></u>	

**Part Two: Respondents opinion on challenge and opportunities on Interest Free banking**

These items will explore respondents' assessment **challenges and opportunity** of Interest Free Banking in Ethiopia a case of Bank of Abyssinia. 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).

<b>Items</b>		<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>1</b>	The effect of current regularity and legal framework challenge on the success of interest free banking your organization					
<b>2</b>	The shortage of professional expertise on interest free banking in the current market or in your organization effect on the success of interest free banking your organization					
<b>3</b>	There is a gap in research and development in interest free banking services and Islamic finance modalities to fill the gap in qualified human resource.					

Items		1	2	3	4	5
	There is Negative attitude of people regarding Islamic banking (wrong association with religion).					
4	Do you believe the awareness level of the community on interest free banking affect the success of interest free banking your organization					
5	The effect of current taxation polices of the country on interest free services and products on the success of interest free banking your organization					

### Part Three: Respondents opinion on opportunities on Interest Free banking

These items will explore respondents' assessment **challenges and opportunity** of Interest Free Banking in Ethiopia a case of Bank of Abyssinia. 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		1	2	3	4	5
1	Do you believed that untouched market for interest free banking are an opportunity for its success					
2	Do you believed that increasing in public interest on interest free banking services and products as an opportunity for the success Islamic banking system.					
3	The current commercial banks including bank of Abyssinia give the service in compliance with the service requirement of Islamic banking					
4	Do you see interest free banking is straight forward and adoptable financial system					
5	Do you see the availability of interest free banking as an opportunity for the success Islamic banking system?					
6	Interest free banking system potential for boost the economy of the country					

**Interview question**

1. What are the major problems or challenges for increase the acceptance or customers of interest free banking in your bank?
2. What is the big opportunity for the interest free banking service in Ethiopia?