



# **Challenges on Interest Free Banking Services: The Case of Commercial Bank of Ethiopia**

**By:**

Kerima Ali Mohammed

Advisor: Dr. Degefa Duressa (PhD)

A research project paper submitted to Addis Ababa University Department of Management in partial fulfillment of the requirements for the Degree of Executive Masters of Business Administration

June, 2016

Addis Ababa

**Addis Ababa University**  
**College of Business and Economics**  
**Department of Management**

**Challenges on Interest Free Banking Services: The Case of  
Commercial Bank of Ethiopia**

**By:** Kerima Ali

**Approved By Board of Examiners**

Dr Degefa Duressa (PhD)

\_\_\_\_\_

\_\_\_\_\_

**Advisor**

**Signature**

**Date**

Dr Birhanu Denu(PhD)

\_\_\_\_\_

\_\_\_\_\_

**External Examiner**

**Signature**

**Date**

Dr Habtamu Birhanu (PhD)

\_\_\_\_\_

\_\_\_\_\_

**Internal Examiner**

**Signature**

**Date**

## **Declaration**

I, the undersigned declare that this research project paper is my original work.  
Furthermore, all sources of materials used for the paper had been duly acknowledged.

Name: Kerima Ali Mohammed

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

Place: Addis Ababa University

## **Certification**

This is to certify that Kerima Ali Mohammed has done a study on the topic “*Challenges on Interest Free banking services: The case of commercial bank of Ethiopia*”. This study is of her original work and all the sources of materials used for the research project paper had been duly acknowledged.

Advisor’s Name: Dr Degefa Duressa (PhD)

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

Place: Addis Ababa University

## Acknowledgments

All praise and thanks to Allah, the Lord of existence, the most Gracious, the most Merciful.

First, I would like to express my deepest gratitude to my advisor, Dr. Degefa Duressa (PhD), for his fruitful support, invaluable comments and guidance at various stages of the study.

I would like to express my deepest thank for those who have paid the price, my dear husband – Negashe and my three special daughters, Khulud Negash, Nihal Negash and Ikhlas Negash. You really paid the price. Thank you so much for your priceless support and patience, really.

I would also like to convey my sincere thanks to my parents, especially my mother Fatuma Nur as she was there from the first day till now in all aspect. Allah Edimeshin Yarzimilign. Amen.

Last but not least; this paper has been made possible through the direct and indirect support and cooperation of various persons for whom I wish to express my appreciations and gratitude especially to my colleague Melese Eshetu.

## Table of Contents

Acknowledgments .....	v
List of Tables.....	i
List of Figures .....	ii
List of Acronyms/Abbreviations .....	iii
Abstract .....	iv
Chapter One: Introduction.....	1
1. Background of the Study .....	1
2. Problem Statement .....	3
3. Research Questions .....	5
4. Objectives of the Study .....	5
4.1 General Objective of the Study .....	5
4.2 Specific Objective of the Study.....	5
5. Significance of the Study .....	6
6. Limitations of the Study .....	6
7. Delimitations of the Study.....	6
8. Organization of the Paper .....	7
Chapter Two: Literature Review .....	8
2.1 Theoretical Literature Review .....	8
2.1.1 Definitions .....	8
2.1.2 Principles of IFB .....	8
2.1.3 Concept of IFB .....	9
2.1.4 The Importance of Shariah Compliance.....	10
2.1.5 International Institution of Islamic Finance .....	10

2.1.5.1 Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) .....	10
2.1.5.2 International Financial Services Board (IFSB) .....	11
2.1.6 Forms/Types of Islamic banking .....	12
2.1.7 An overview of Interest free/Islamic banking Industry .....	12
2.1.8 Islamic and conventional banking .....	13
2.1.9 Major IFB Products .....	15
2.1.9.1 Islamic Banking Deposit Products .....	15
2.1.9.2 Islamic Banking Financing Products .....	17
2.2 Empirical Literature Review .....	19
2.2.1 Empirical Literature Review-General .....	19
2.2.2 Empirical Literature Review-Ethiopian Context .....	22
Chapter Three: Research Methodology .....	24
3.1 Study Design .....	24
3.2 Study Area .....	24
3.3 Population .....	25
3.4 Unit of Analysis .....	26
3.5 Data Type and Source .....	26
3.6 Sampling methods and sample size .....	26
3.6.1 Sampling Methods .....	26
3.6.2 Sample Size Determination .....	26
3.7 Method of Data Collection .....	30
3.8 Data Analysis Technique .....	31
Chapter Four: Data Analysis and Interpretation .....	33
4.1 Introduction .....	33
4.2 Characteristics of respondents .....	33
4.3 Reliability Test Statistics .....	36
4.4 Status of IFB in CBE .....	37
4.5 Demand for IFB products .....	44



4.6Customers Awareness about IFB Products. ....	48
4.7Capacity of the bank to provide IFB products.....	50
4.8Limited Type of IFB Products.....	51
4.9Challenges of IFB products/Services .....	52
Chapter Five: Conclusion and Recommendation.....	57
5.1 Introduction.....	57
5.2 Conclusion.....	57
5.3 Recommendation.....	58
5.4Recommendation for further study.....	61
References.....	62
Glossary .....	i
Annex.....	iii

## List of Tables

Table 1 Addis Ababa and Dire Dawa districts IFB deposit and credit customers .....	25
Table 2: Sample Size Determination.....	27
Table 3: Number of Sample Branches from Each District.....	28
Table 4: Total Number of Customer Sample from Each Branch .....	29
Table 5: Summery of Sampling Unit, Sample Size Determination and Sampling Technique.....	30
Table 6: Questionnaire Response Rate.....	33
Table 7: Characteristics of Sample Customers.....	34
Table 8: Characteristics of Sample Staffs .....	35
Table 9: Reliability of Statistics (Test): Deposit Customers .....	36
Table 10: Reliability of Statistics (Test): Deposit Staffs.....	36
Table 11: Reliability of Statistics (Test): Credit Customers.....	36
Table 12: Reliability of Statistics (Test): Credit Staffs .....	37
Table 13: Interest Free Banking Windows (IFBW) .....	38
Table 14: IFB Deposit Product Utilization.....	39
Table 15: Performance of Fund Mobilized and Customer base .....	39
Table 16: Five year Performance of SDD account.....	41
Table 17: IFB Financing Product Utilization .....	42
Table 18: Deposit Customers Response about Demand.....	44
Table 19: Deposit Staffs Response about Demand .....	45
Table 20: Credit Customer Response about Demand.....	46
Table 21: Result from financing staff response.....	47
Table 22: Result from IFB Credit Staff about Products .....	48
Table 23: Result of Customer Awareness about IFB Products. ....	49
Table 24: Result for capacity to deliver IFB products .....	50

## **List of Figures**

Figure 1: Performance of IFBW .....	38
Figure 2: The Performance of Deposit Mobilized and Customer Base.....	40
Figure 3: SDD performance for the past five year .....	41
Figure 4: IFB Financing Product Utilization.....	42

## **List of Acronyms/Abbreviations**

<b>CBE</b>	Commercial Bank of Ethiopia
<b>IFB</b>	Interest Free Banking
<b>IFBW</b>	Interest Free Banking Window
<b>MIS</b>	Management Information System
<b>NBE</b>	National Bank of Ethiopia
<b>PLS</b>	Profit and Loss Sharing
<b>SDD</b>	Special Demand Deposit

## Abstract

*The main objective of this study is to empirically examine challenges on Interest free banking services in Ethiopia with particular reference to the commercial bank of Ethiopia. The study has employed descriptive research based on survey and the data are of cross sectional type. The study has used both primary and secondary data which are quantitative and qualitative in nature and have been collected through structured and semi structured questionnaire and interview. A total of 485 sample respondents were taken through multistage sampling. Of the total sample interest free banking customers and staffs of the bank constitutes 383 and 102 respectively. The data was analyzed using descriptive statistics of mean, frequency and percentage using SPSS version 20 software. Based on the analysis of the obtained data, this research has found out the challenges to IFB services as: lack of commitment of the bank, lack of Shariah advisor, lack of supportive regulatory directives , Problem related to Ethiopian Commodity Exchange (ECX) law, lack of capacity to deliver IFB product at full rage, lack of awareness of customer about IFB products, lack of trust and confidence of customers, inadequate marketing and promotion, double taxation, nature of IFB products, unavailability of IFB products in all of its branches and the IFB being delivered in a Window model. Accordingly, the following recommendations were forwarded by the researcher based on the results of the findings in conjunction with literature review reflections: aggressive promotion and marketing campaign about IFB products, provide sustainable and continuous training to build the capacity of the manpower, the bank shall increase accessibility of its products with the expected services attached to the products, the bank has to have Shariah advisor, give the required attention and focus for the business and the bank has to be transparent in its IFB business undertaking, in addition to these NBE directives, tax and ECX law shall include exceptions for IFB business undertaking.*

# **Chapter One: Introduction**

This research paper empirically examines the challenges on interest free banking services with particular reference to Commercial Bank of Ethiopia. This chapter specifically provides background information of the paper and it is organized in eight sections. The first section deals with background information and followed by statement of the problem. Research questions and objectives of the study are presented in the third and fourth section respectively. The fifth part describes the significance of the study. Section six and seven discuss limitations and delimitations of the study, respectively. The final section presents organization of this research paper.

## **1. Background of the Study**

The conventional banking system excludes the Muslim society, not by design, but due to its principle of using interest while playing its financial intermediary role and its involvement in business that the religion does not allow to be engaged in. This significant portion of the world population remained unbanked for centuries. Thus, this has created strong reservations against conventional banking system from the Muslims side and they demanded banking system that does not contradict with their religion. Hence, Interest free/Islamic banking (IFB) is being introduced on this ground. According to Metwally (1984 as cited in Al-sultan, 1999) in Muslim society banking activity is acceptable but what is not acceptable is the usage of interest for financial intermediation and the involvement of business activity that contradict the Islamic law. Thus, Interest free/ Islamic banks were established to conform to Islamic law- Shariah and meet the banking needs of this society.

It is emerging industry not only in Muslim countries but also in non-Muslim countries. Nowadays, many countries are experiencing “Dual banking” system where interest-free banks operate along with conventional banks. For instance it is successful in countries like United State of America, United Kingdom and Europe, (Garas, 2007 as cited in Irfan, Majeed & Zaman 2014).

To enable IFBs achieve their objectives in accordance with Islamic laws, they have devised (and are still devising) new instruments/products to meet the demand of their customers and win the competition they face from the conventional banks.

Ethiopia having a significant Muslim population provides a huge potential for Islamic/interest free banking though interest free banking is meant for all those who would like to use the banking service apart from religious restriction. The study made by Mohammed (2012), has found out that there is need for Islamic banking products and services in Ethiopia. The significant Muslim population – according to the 2007 national census, the Muslim population comprises 33.9% of the total population ([www.csa.gov.et](http://www.csa.gov.et) accessed on 12/02/2016) - in Ethiopia, offers the opportunity for substantial customers that would patronize Islamic banking products.

National Bank of Ethiopia (NBE) has authorized banks to undertake IFB business in year 2011; following this authorization banks have started IFB services in year 2013. According to Sefiani (2014), for the sizable Muslim population in Ethiopia, there is a need for adequate banking services to serve this segment of the population. Banks reach to their customers through providing products and services that meet the need and wants of these customers. According to Aris et al (2013), the increasing trends of Islamic Finance, Islamic Financial institutions (IFIs) around the world are encouraged to develop and innovate new products in order to meet the ever-changing demand from its customers and potential customers. In order to satisfy the banking need of this population, banks shall provide adequate IFB services, create conducive environment and encourage the use of these services accordingly.

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

Thus, the aim of this study is to empirically identify challenges on IFB services with particular reference to commercial bank of Ethiopia.

## 2. Problem Statement

As already mentioned under the background section, Ethiopia has large Muslim population whose contribution to the national economy is also enormous. This section of the society has been disadvantaged to modern finance, not by design, but due to their faith and the secular nature of the financial industry. They have strong reservations against conventional banks whose functions are based on interest, thus this community need banking system that best suits their need and at the same time in line with their religion.

According to Teferi (2015), introduction of IFB does not only create inclusive financial system for the Muslim population but also has a potential to influence and enhance the economic development of the country through resource mobilization and employment creation by encouraging people to use the banking system.

Although the international experience of interest free banks and even the theoretical literature shows the existence of several types of IFB products, the information obtained through interview and observation from two Commercial bank of Ethiopia shows that it has availed some of IFB products and the availed products are not also being utilized as expected.

At International level there are several empirical studies on Islamic banking and finance. The studies investigated several aspects of the Islamic banking service from the type of services (scope of service) to challenges faced by the Islamic banks. Few of these studies are given below.

According to the study of Aris et al (2013), in Malaysia Islamic banks serves Wadiah Amana, Quard Hassan, Mudarabah, Musharakah, Murabaha, Ijara, Istisna, Bai Inah, Bai Bithaman Ajil. On the other hand, research work conducted by Olaoye et al (2013) revealed that products availed by interest free banks in Thailand and Bangladesh includes: Mudarabah, Musharakah, diminishing partnership, Murabahah, Ijarah, a lease ending in the purchase of the leased asset, Al- Istisna, Istisna Tamwili, Salam, Current account, saving account and investment account.

On the other hand the research work which was conducted to assess the challenges of interest free banking so far has been conducted by different researchers, in different contexts. According to the findings of Iqbal, Ahmed & Khan (1998), Jabr (2003), Karbhari, Naser &



Shahin (2004), Sahle et al(2005), Ibrahim (2012), Kinyanjui (2013) and Bello & Abubakar (2014), interest free banking faces challenges in its implementation and operation. These studies have revealed that though there are some challenges common to many countries, there are also challenges which are unique to each country due to social, cultural, economical, technological, political, religion and other factors. However, the common findings of all the above are: inadequate legal and poor supervisory framework, inadequate manpower with the requisite knowledge, shortage of experts in Islamic banking, lack of awareness and high competition from the conventional banks.

In Ethiopia, however, few studies were conducted on the attributes of IFB. Among these studies Mohammed in 2012 has studied the „Prospects, Opportunities and Challenges of Islamic Banking in Ethiopia“ and his work has identified the potential challenges as: 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 wrongful association with specific religion and the global terrorism. This study was undertaken before the practical introduction of the IFB in the country. Therefore, it was not based on actual observation of facts on the ground. Debebe (2015) has conducted a study on „Factors Affecting Customers to Use Interest Free Banking in Ethiopia“. The study is centered on „customers“ intention and willingness to use interest free banking“. The result showed that perceived relative advantage, perceived compatibility, customers“ level of awareness and subjective norm have a significant positive impact on the attitude towards interest free banking in commercial bank of Ethiopia. This study is about impact assessment on the attitude towards IFB usage which does not address the current problem at hand. On the other hand Teferi’s (2015) study is about „Contribution of IFB to economic development and its prospect in Ethiopia“. The study has assessed the contribution of including the Muslim population in to the banking (financial system) to the economic development and GDP growth.

Thus, none of the above studies have addressed the reasons for why the bank has availed some of IFB products to the market. Except in the international studies which took realities of other countries, to the best of the researcher’s knowledge, there is paucity of empirical study in Ethiopian context related to the scope of service and challenges on IFB services. This, study, therefore, attempts to fill this research gap by investigating the challenge faced by service

providers and users of IFB products and scope of service provided by Ethiopian banking through IFBW including whether there is unmet demand of users, awareness of customers and capacity of bank as these have been identified in the literature as challenges, and commercial bank of Ethiopia is taken as a case study.

### **3. Research Questions**

Based on the above problem statement, the study will try to answer the following questions

- How is the extent of utilization of IFB services currently in Commercial Bank of Ethiopia?
- What are the challenges to deliver and use IFB services to the bank and customer?
- Why did the bank limit its products to what it provides now?
- What is the demand level for IFB products other than those currently provided?
- What is the awareness level of customers about IFB products?
- What is the capacity level of the bank to provide IFB products?

### **4. Objectives of the Study**

#### **4.1 General Objective of the Study**

The general objective of the study is to empirically identify the challenges on Interest free banking services with particular reference to Commercial bank of Ethiopia.

#### **4.2 Specific Objective of the Study**

This study specifically strives to achieve the following special objectives:

- To assess the extents of IFB service utilization in Commercial Bank of Ethiopia.
- To examine the challenges on delivery and use of interest free banking products.
- To assess the availability of demand for IFB products other than those currently provided by the bank.
- To identify the reasons that make the bank limit its products to what it provides now.
- To assess customers awareness level IFB products/services.
- To assess capacity of the bank to deliver the IFB products/services.

## **5. Significance of the Study**

IFB is a relatively new business model in Ethiopian banking system. It is also growing in its applicability among Muslim as well as non-Muslim countries to accommodate the Muslim population, who otherwise, are excluded from financial services due to religion factor. It is believed that including this section of the population into financial service provision will expand the financial frontier and bring about economic benefit both to the country and the beneficiaries. It is, therefore, believed that the study of the subject is relevant and current especially in our country that has just embarked on the services.

## **6. Limitations of the Study**

The study area is limited to Addis Ababa city and Dire Dawa districts of CBE due to time and money constraint. In addition the study included interest free banking customers and staffs only. The other limitation was it might be too early to conclude about the observed and prevailing knowledge gap, awareness problem and demand issues.

## **7. Delimitations of the Study**

It is bounded by both area coverage and problem addressed. The study is delimited to only identifying the challenges on the delivery and use of interest free banking products in commercial bank of Ethiopia and why services are limited to few products. It is based on the case of one bank-Commercial Bank of Ethiopia and its customers. Thus, an overall generalization to Ethiopia may naturally miss few elements. However, it is believed that CBE, with its extensive branch network all over the country, may fairly represent the country.

## **8. Organization of the Paper**

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

## Chapter Two: Literature Review

In this section of the study theoretical and empirical literature review has been conducted which has involved details in each of the sub sections.

### 2.1 Theoretical Literature Review

#### 2.1.1 Definitions

The definition of Islamic/interest free banking revolves around Islamic law. In the definition given by Ziauddin (1994), the term "Islamic banking" means conduct of banking operations in consonance with Islamic teachings. The definition given by Moin (2008) depicts Islamic banking as the system of banking consistent with principles of Islamic law (Shariah) and guided by Islamic economics. According to Kettell (2011), Islamic banks provide commercial services that comply with the religious injunctions of Islam. They provide services to their customers free from interest (the Arabic term for which is *riba*). The giving and taking of interest is prohibited in all transactions under the Islamic financial principles. Shariah prohibits the practice of giving or accepting additional money for money that is borrowed. Bello & Abubakar (2014) define Islamic banking as banking system that operates strictly on the basis of *Shariah*. Thus, based on the definition given by the above authors, Islamic banking is banking operations based on Shariah which prohibits the giving and taking of interest in all transaction and in consonant with Islamic finance and economic principles.

#### 2.1.2 Principles of IFB

The operations of Islamic banking primarily are based on a profit and loss sharing (PLS) principle. An Islamic bank does not charge interest but rather participates in the yield resulting from the use of funds. The depositors also share in the profits of the bank according to a predetermined ratio. There is, thus a partnership between the Islamic bank and its depositors, on one side, and between the bank and its investment clients, on the other side, hereby acting as a manager of depositors' resources in productive uses, that is an interest free/ Islamic bank in

relation to its clients plays the role of partner, investor and trader. The complexity of Islamic banking comes from the variety (and nomenclature) of the instruments employed, and in understanding the underpinnings of Islamic law (Kettell 2011).

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 (Samad, 2004; Bello & Abubakar, 2014; Kettell , 2011) .

1. Predetermined loan repayments as interest (*riba*) is prohibited
2. Speculative behavior is prohibited
3. Only *Shariah*-approved contracts are acceptable
4. Profit and loss sharing is at the heart of the Islamic system
5. Contracts are sacred
6. The implementation of *Zakat* the compulsory Islamic tax.
7. Transparency in all transactions.

These basic principles are then applied to the various specific transactions of, for example pledge, deposit, guarantee, agency, assignment, land tenancy, *waqf* foundations (religious or charitable bodies) and partnerships.

### **2.1.3 Concept of IFB**

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

### **2.1.4 The Importance of Shariah Compliance**

While financial soundness may be enough for retaining the confidence of clients of a conventional bank, in the case of Islamic bank, Shariah compliance is equally important. An Islamic bank could fail as much due to non compliance to the Shariah as for financial imprudence. Therefore, it should be ensured that all activities of an Islamic bank comply with Shariah principles Al-Jarhi and Iqbal (2001). According to Kettell (2011), to ensure financial activities are in conformity with the Shariah law, religious Supervisory boards are mandatory for Islamic banks. The Shariah Supervisory Board (SSB), sometimes called the Shariah supervisory committee, examines contracts, dealings and transactions to assure that Islamic beliefs are being implemented. The board guarantees, and certifies, that the banking activities are halal (permissible). It is merely an advisory body, but nevertheless it has an authoritative and respected function because the bank entrusts the SSB with questions as to the permissibility of its activities. Being part and parcel of Islamic economic activities, Islamic/Interest free banking and financial activities are therefore subject to the Shariah law.

### **2.1.5 International Institution of Islamic Finance**

The industry has set up institutions to guide operations around the world, although it has been difficult to ensure standardization of Islamic products across different countries. According to Sefiani (2014), there are two internationally renowned institutions. These institutions have been widely used as standard setting bodies and benchmarks for Islamic and IFB products- Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) and International Financial Services Board (IFSB). The detail is shown as follows.

#### **2.1.5.1 Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI)**

AAOIFI was established in Bahrain in 1991 with the objective of issuing international standards for the Islamic finance industry on accounting, auditing, and corporate governance. AAOIF protocols can be used as a support to issue standards for IFB. AAOIFI has 88 standards including 48 Shariah standards, 26 Accounting standards, 5 Auditing standards, 7 Governance standards and 2 Ethics standards. AAOIFI has over 200 members in more than 40 countries. Members include regulatory and supervisory authorities, multilateral agencies, private sector

entities, professional firms and industry associations. AAOIFI standards have introduced greater harmonization among Islamic finance actors across the world. The advantage of rolling out AAOIFI-compliant products is that they are in line with internationally recognized standards. The products launched have been approved, tested and accepted by the Muslim community. Several central banks and monetary agencies from secular-based countries have heavily relied on AAOIFI standards to develop their IFB industry (Sefiani, 2014).

#### **2.1.5.2 International Financial Services Board (IFSB)**

The other institution is IFSB that is based in Malaysia, which was launched in 2002 and serves as an international standard setting body that provides prudential standards and guidelines for regulatory and supervisory agencies to ensure soundness and stability of the Islamic Financial industry including: retail banking, capital markets and Takaful (Islamic insurance). The IFSB has 13 standards, 5 guide notes, 1 technical note. IFSB standards are fully compatible with AAOIFI standards and allow for further enhancing the standardization of the product offering. IFSB is the sole international regulatory body offering prudential standards for the Islamic banking industry (Sefiani, 2014).

#### **2.1.5.1 Advantages of Adopting AAOIFI and IFSB**

According to Sefiani (2014), banks that adopt AAOIFI and IFSB obtain several advantages:

- 1) IFB can use models of products of existing institutions
- 2) Consumers can more easily understand products and evaluate their risks and returns
- 3) Potential for fewer disputes regarding a product being Shariah compliant
- 4) Favorable tax treatment of products which would have otherwise had a double taxation due to the nature of IFB products
- 5) Reduced risk of Shariah arbitrage



### **2.1.6 Forms/Types of Islamic banking**

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

- I. Islamic banks operating within a financial system where all banks are Islamized
- II. Islamic banks operating alongside other conventional banks and
- III. Shariah- complaint branches, windows and funds established by some conventional banks.

### **2.1.7 An overview of Interest free/Islamic banking Industry**

Muslim scholars have developed a radically different model of banking which does not make use of interest. The earliest experiments in Islamic banking took place in most cases on individual initiative with governments playing a more or less passive role. In 1963, Islamic banking came into existence on an experiment basis on a small scale in a small town of Egypt. The success of this experiment opened the doors for a separate and distinct market for Islamic banking and finance. As a result, in 1970s Islamic banking came into existence at a moderate scale and a number of full-fledge Islamic banks was introduced in Arab and Asian countries where most of these Islamic banks were in Islamic countries (Ziauddin 1994).

Having started on a small scale, Islamic banks and non-banking financial institutions are now in operation even on more intensive scale (Moin 2008). The mile stone, in growth and popularity of Islamic Financial Institutions (IFIs), was the Conference of Foreign Ministers of Muslim countries (1973), where decision of establishment of Islamic Development Bank (IDB) was taken place. It has aimed to promote Islamic Banking with the objective of providing development funds for Infrastructure development projects in developing or less developed countries. Then the first commercial bank was established in United Arab Emirates (UAE) in 1974 on private initiative, followed by Islamic Development Bank (IDB) establishment as an international financial institution in 1975 held in Jeddah, Saudi Arabia (Pasha 2014).

By the mid 1980s, Interest free banking, based on Islamic principles became an established part of mainstream banking in the Middle East and South Asia. They continued to sprout across South and East Asia in addition to Turkey and the Arab countries. Now the practice of Islamic

banking is not limited to Arab and Muslim countries but has spread "from East to West", all the way from Indonesia and Malaysia towards countries where Muslims are minorities, such as UK, Luxemburg, Denmark, Australia, India and the Americas. Not only that many conventional banks including some major multinational western banks have also started using Islamic banking techniques (Iqbal & Molyneux, 2005).

According to Standards and Poor's rating services (2014), the assets held by Islamic financial institutions worldwide is estimated to be \$ 1.8 trillion and likely to sustain double digit growth over the coming few years to reach about \$ 3 trillion. The sound economic resilience of the industry's twin engines- Malaysia and the Gulf cooperation council (GCC: comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE) will help the industry sustain strong growth rate.

Despite the economic and financial downturns that have engulfed many international economic and financial centers, Islamic financing still exhibits a two-digit growth over the past few years. The industry is operating across 75 jurisdictions with 600 institutions. As a result of this growth and spread, Islamic finance is no longer confined to its traditional Muslim and Arab markets; rather, it has spread, in various degrees, all over the globe (Belouafi & Chachi 2014).

### **2.1.8 Islamic and conventional banking**

Islamic banking is operating in the same society where conventional banks are operating and perform all those functions which are expected from a financial institution. However, the philosophy and operations are different. The basic principles underlying Islamic financial transactions are that the purpose of financing should not involve an activity prohibited by Shariah. Islamic banking and finance (IBF) is an ideological discipline that draws on *Shariah* principles to expunge interest and other exploitative elements from the economic and financial spheres of human society (Khan & Bhatti 2008).

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

Just like conventional, Islamic banks are dependants on their depositors' money as a major source of funds, with the exception that they are not allowed guaranteeing any rate of return on

the basis of interest. Moreover, the nominal value of some deposits accounts cannot even be guaranteed, because they are reliant upon the profit- and loss-sharing scheme. While the conventional banks guarantee the capital and rate of return, the Islamic banking system, based on the principle of profit and loss sharing, cannot, by definition, guarantee any fixed rate of return on deposits. In some cases the capital is not guaranteed either, because if there is a loss it has to be deducted from the capital (Mounira 2008).

Although profit sharing and interest-based lending may seem alike, the differences are clearly more than semantic ones. The yield is not guaranteed in the profit-sharing mode. In addition, in interest-based lending the loan is not contingent on the profit or loss outcome, and is usually secured, so that the debtor has to repay the borrowed capital plus the fixed (or predetermined) interest amount regardless of the resulting yield of the capital. Thus, with interest-based lending, the financial losses fall most directly upon the borrower (Kettell, 2011).

The utilization of the funds from the institution by a business house or an enterprise is on a profit and loss sharing basis. Gains from the business as well as losses earned due to the business are shared between the institutions and the enterprise. Investing in Islamic banks may provide more profit and less risk because the financial institution has its own interest as it acts as a partner (Mohammed 2013).

Each and every investment based on PLS leads to asset creation rather than debt creation. Islamic banking does not allow the creation of debt through direct lending and borrowing because credit can only be provided through lease or sale-based financing. Consequently, Shariah compliant investments follow the structure of an exchange of ownership in tangible assets or services where money's role is to facilitate the payment mechanism to implement the transfer. Moreover, risks are supposed to be shared among all parties: investors and entrepreneurs bear the business risk for a share in the profits. This contrasts with conventional banking where transactions involving interest payments are common (Chong and Liu, 2009, Kahf, Ahmad, and Homud, 1998).

Islamic banks use the same tools and procedures as conventional banks in those areas where there is no conflict between banking operations and Islamic principles. These activities include

foreign exchange transactions, domestic and international transfers, letters of credit and availing safe custody (Al-sultan 1999).

### **2.1.9 Major IFB Products**

Islamic financial products offer new opportunities for institutions to address previously unexplored consumer and business segments. The introduction of Islamic financial products across the world has been in response to the growing need of a significant segment of the marketplace that refused to deal with interest-based instruments. Islamic banks aim at addressing the needs of new segments by creating a range of Islamically acceptable products, the development of which pose significant challenges arising from the need for *Shariah* compliance in addition to regulatory complexities. Marketing such products is another challenge in light of competition from conventional banks and the need for innovative products (Hassan & Lewis 2007).

Interest free/Islamic banking operates according to Islamic law which requires all the transaction to be Shariah compliant including the non receipt and payment of interest. It involves profit-sharing as per agreement and loss/risk sharing as per investment between banks and customers as its main method. It provides several products through different modes. The products are recognized based on the contracts instead of the commercial orientation (Kettell 2011). Islamic banks have devised (and still devising) new instruments/products to enable them achieve their objectives in accordance with Islamic laws (Al-Sultan 1999).

#### **2.1.9.1 Islamic Banking Deposit Products**

According to Kettell (2011), in the mobilization of funds, Islamic banks depend on four main sources that include shareholders' funds, current accounts, investment accounts and savings accounts. The bank and the investment deposit holders share the realized profit in accordance with the ratio agreed upon between the parties at the time of contracting. The deposit in the current account is treated as if they are loans from the clients to the bank and therefore, bear no yield to the account holders. However, being loans to the bank, their principal is guaranteed by

the bank. According to Ziauddin (1994), Hassen & Lewis (2007) and Kettll (2011) the source of deposit mobilization of IFB products are shown as follows.

### **I. Unrestricted Investment Deposits (Unrestricted Mudaraba)**

This type of deposit is an earning deposit which is mobilized with the knowledge that bank acts as the Mudarib (manager) and invests the fund without restriction and intervention of the capital provider in any Shariah compliant manner. The profit on the investment will be shared as per agreement and loss will be shared by the depositor (capital provider). The bank has discretion to participate in the investment. The bank can pool the money for its daily IFB business activities.

### **II. Restricted Investment Deposit (Restricted Mudaraba)**

Such type of IFB deposit is an earning deposit which is mobilized with the knowledge that bank acts as the Mudarib (manager) and invests the fund in restricted investment based on active intervention of the capital provider complemented with professional advice from the bank side. The profit on the investment will be shared as per agreement and loss will be shared by the depositor (capital provider).

### **III. Wadiah (Safekeeping) Deposit**

It is a peculiar non-earning type of IFB deposit that operates under the contract of Wadiah Yad Dhamanah (guaranteed custody). The bank accepts deposits from its customers looking for safe custody and convenience and requests permission to make use of the customer funds for investment purposes promoting transparency. The customers may withdraw their balances at any time. Profit generated from the use of the customers' funds belongs to the bank. However, the bank may at its absolute discretion reward the customers by declaring profits to them. Under the contract of Wadiah, the custodian i.e. the Bank is not allowed to mention or to promise any reward on the deposit received. The owner/depositors too cannot demand any rewards or return from their Bank on their savings.

#### **IV. Demand Deposit (Amana Current Accounts)**

Amana Current accounts are non-earning deposits that operate based on the principle of al-wadiah, whereby the depositors are guaranteed repayment or withdrawal of their funds on demand. At the same time, the depositor does not receive return for depositing funds in a current account, because the guaranteed funds will not be used for profit and loss ventures.

##### **2.1.9.2 Islamic Banking Financing Products**

As a general rule, Islamic finance involves the carrying out of investment and /or the purchase of goods, services and assets. Islamic banks provide financing using two basic methods. The first depends on profit and loss sharing and the second involves the sale of goods and services on credit and leads to the indebtedness of the party purchasing those goods and services (Al-Jarhi and Iqbal 2001).

Financial instruments based on Islamic principles have been developed to facilitate everyday banking activities by providing halal (Shariah-compliant) methods of lending or borrowing money and still offering some acceptable returns for investors. Theoretically, there are several IFB financing products which also include other than the below cited ones. Practically, banks do not provide all of the IFB products. Thus, this research also shows the popular IFB financing products which is described by the following researcher as major ones. According to Hassan & Lewis (2007), Al-Jarhi and Iqbal (2001); Kettell (2011); and Bello & Abubakar (2014) some of popular Islamic financing products being marketed worldwide by Islamic banks are:

##### **I. Mudaraba (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.

## **II. Murabaha (Cost-Plus Sales Contract)**

This type of contract is mostly used in the procurement of equipment. It is a sales contract between Islamic bank and its client at a fixed profit called mark-up. In this contract, the client will provide all the specifications of the commodity and the Islamic bank will take the risk of purchasing it for the client at a cost plus mark-up which the client can either pay in installment or sum at a spot or at a stated period.

## **III. Ijara (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.

## **IV. Musharaka (Equity Partnership)**

Musharaka 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 to the capital formation as well as in sharing profits and loss.

## **V. 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.

## **VI. Istisna (contract of manufacture)**

It is a contract in which a party orders another to manufacture and provide a commodity, the description of which, delivery date, price and payment date are all set in the contract. It is used by Islamic banks, and consists of two separate Istisna contract.

## **2.2 Empirical Literature Review**

### **2.2.1 Empirical Literature Review-General**

IFB industry is highly nascent in comparison to the conventional banking industry. It is striving to develop its own institutional, operational, and regulatory infrastructures in order to grow and prosper (Khan & Bhatti 2008).

At international experience, many studies on challenges of Interest free/Islamic banking have been conducted. These studies have shown that Islamic banking in Muslim or non-Muslim countries have faced a number of challenges,(Iqbal, Ahmed & Khan 1998, Bello & Abubakar 2014, Njamike 2010, Ibrahim 2012, Kinyanjui 2013, Jabr 2003, Saleh and Zeitun (2005) & Karbhari, Naser & Shahin, 2004). Thus, Ethiopia is not an exception.

However, to the best knowledge of the researcher, there is paucity of research work on the topic under study in Ethiopian context and the researcher believed this will make the study to contribute knowledge and fill the gap in the area.

According to studies conducted on challenges of IFB at international level, the identified challenges in the researchers' respective countries differ due to the difference in each country's social, economical, cultural, religious, political, and technological and other factors though there are some common challenges to these countries. Thus, the researcher has reviewed some of the studies and has presented as follows.

Iqbal, Ahmed & Khan (1998) has divided the challenges of Islamic banking as institutional and operational challenges. 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.

The study made by Bello & Abubakar (2014) revealed that challenges of interest free banking in Nigeria are: inappropriate institutional framework, inadequate legal framework, lack of equity institutions, poor supervisory framework, disparity in accounting standard, lack of secondary financial markets, lack of short-term financial instruments and institutions religious and cultural differences, lack of innovations in financial products, lack of profit sharing finance, Shariah related issues, inadequate manpower with the requisite knowledge, lack of awareness and competition.

According to Njamike (2010) the major problems and challenges in introducing Islamic banking in Zimbabwe are 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, current political and economic situation, and default culture.

The research made by Ibrahim (2012) showed that legal frame work, manpower, competition, financial literacy, religion and moral hazard constitute significant constraints on the operation of the interest-free window. and to overcome these challenges and improve the performance of the interest free banking system his work has recommended for vigorous public enlightenment (sensitization) program on interest-free banking, intensive manpower training and development, promotional efforts, introduction of innovative services and products, progressive monitoring and supervision of business partners/ clients, cooperation with other interest free institutions and relevant stakeholders, expansion of the scope of the operational guidelines of non-interest banking by the Central Bank of Nigeria and active government participation in Interest-Free Banking at all levels.

Kinyanjui (2013) argue that lack of legal support, lack of standard financial contracts and products, nature of Islamic banking, lack of proper mechanism of transparency and disclosure to the public, shortage of experts in Islamic banking, absence of accounting (and auditing) standards pertinent to Islamic banks, and potential conflicts with central banks are the challenges of interest free banking in Kenya.

Study conducted by Jabr (2003) in the Palestinian territories concludes that challenges of Islamic banks are: 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 Shariah; excessive short-term financial instrument; inability to make use of Mudaraba and Musharaka financial institutions; inferior technical resources and technology; Islamic banks are compel to recruit staff trained in traditional banking; inability to differentiate ownership from management; and lack of financial innovations.

Saleh and Zeitun (2005) 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.

The study conducted in the United Kingdom regarding problems, challenges and opportunities of Islamic banking has identified the main problem as lack of expert staff and competition from the conventional banks. It has been concluded that the e-banking can play pivotal role for the success of Islamic banking. There is also a need to recruit professional individuals who have the knowhow about the Islamic banking (Karbhari, Naser & Shahin, 2004).

The research works reviewed so far were conducted in different country which is based on the respective countries reality. However, the empirical findings of all of these researchers agree on one thing, that interest free banking faces challenges in its implementation and operation. These studies have revealed that though there are some challenges common to many countries, there are also challenges which are unique to each country. Thus, the researcher is motivated to identify challenges to deliver and use of IFB product in the Ethiopian context.

### 2.2.2 Empirical Literature Review-Ethiopian Context

In Ethiopia, IFB is a recent phenomenon. As a result, there is little empirical literature on the area. The studies conducted so far include the following: Mohammed (2012) has conducted research on „Islamic Banking: Prospects, Opportunities and Challenges in Ethiopia“, research work conducted by Teferi (2015) was on „contribution of IFB to economic development and its prospect in Ethiopia“, on the other hand, study conducted by Debebe (2015) is on „Factors Affecting Customers to Use Interest Free Banking in Ethiopia“. Accordingly, their findings in brief and the gap thereto is presented as follows.

Mohammed in 2012 has studied the „Prospects, Opportunities and Challenges of Islamic Banking in Ethiopia“ and his work has identified the potential challenges as: 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 wrongful association with specific religion and the global terrorism. This study was undertaken before the practical introduction of the IFB in the country. Therefore, it was not based on actual observation of facts on the ground and the respondents do not have real life experience on interest free banking products delivery and use.

Debebe (2015), has conducted a study on „Factors Affecting Customers to Use Interest Free Banking in Ethiopia“. His study has centered on „customers“ intention and willingness to use interest free banking“. The results showed that perceived relative advantage, perceived compatibility, customers“ level of awareness and subjective norm have a significant positive impact on the attitude towards interest free banking in commercial bank of Ethiopia. This study is about impact assessment on the attitude towards IFB usage which does not address the current problem at hand.

On the other hand Teferi's (2015) study is about „Contribution of IFB to economic development and its prospect in Ethiopia“. He assessed the contribution in including the Muslim population in the banking (financial system) to the economic development and GDP growth. Except research conducted by Mohammed, the other studies are not related to the current study.

Therefore, except in the international studies which took realities of other countries, to the best knowledge of the researcher, there is paucity of empirical study in Ethiopian context related to the scope of service and challenges of providing and using IFB products. This study, therefore, attempts to fill this research gap by investigating the challenge faced by both service providers and users of IFB products and scope of service provided by Ethiopian banking through IFBW including whether there is unmet demand of users, awareness of customers and capacity of bank as these have been identified in the literature as major challenges, and commercial bank of Ethiopia is taken as a case study.

## **Chapter Three: Research Methodology**

This chapter presents the underlying principles of research methodology and design. The purpose is to choose the appropriate research method for the study. Keeping the purpose of this study, the researcher has adopted both quantitative and qualitative approach. Conducting mixed methods research involves collecting, analyzing, and interpreting quantitative and qualitative data in a single study or in a series of studies that investigate the same underlying phenomenon (Onwuegbuzie & Leech as cited in Debebe, 2015). The study employed descriptive research based on survey and the data are of cross sectional type to construct an empirical finding on the challenges to deliver and use interest free banking products in Ethiopia with particular reference to CBE.

### **3.1 Study Design**

To achieve the stated objectives of this study descriptive research design of survey method has been adopted due to its appropriateness. Both qualitative and quantitative data were collected from respondents and also bank's internal documents-report were consulted for the intended purpose.

### **3.2 Study Area**

The research was conducted at commercial bank of Ethiopia focusing IFB windows specifically to identify the challenges related to the delivery and use of the window's products. CBE, a state-owned institution established in 1942 and it is the largest bank in the country. It currently has 1006 branches nationwide constituted in 15 districts. It provides both conventional and IFB products and services to its customers. The bank has started providing IFB services since October 2013. The bank provides these products through its selected 420 branches and has 204,407 customer base with deposit that amounts to birr 2,145,191,731 and has provided finance which amounts to birr 71,687,589 as of December 2015.

### 3.3 Population

The study population is customers and employees of CBE who use products of IFB and work at IFB windows respectively. The bank's districts are divided as Addis Ababa city and outlying districts with a total number of 15 districts. The Addis Ababa districts are four in number while the outlying districts are 11. From the 15 districts of the bank, Dire Dawa and Addis Ababa city districts have been considered for this research. These districts have been selected on a purposive basis. The major reason for selecting Dire Dawa District -that holds the eastern part of the country which includes major towns Dire Dawa, Harar and Jigjiga- is that it serves significant number of IFB customers as compared to other districts and it is highly Muslim populated area. The other district which is selected as research area is Addis Ababa city districts which constitute four districts in its domain. The reason for selecting Addis Ababa districts is that, it has the second largest IFB customers next to Dire Dawa district. The selected districts constitute 44% of the bank's total IFB customers with significant deposit and credit fund amount. The customer population in these districts is 90,639 out of this Addis Ababa districts IFB customers constitutes 44,151 while Dire Dawa district IFB customers are 46,481. In addition to the customer population, IFB staff population in these districts is 137, wherein 97 are in Addis Ababa and 40 are in Dire Dawa districts. The table below shows the details as follows:

**Table 1 Addis Ababa and Dire Dawa districts IFB deposit and credit customers**

District	Total Number of customer
East Addis	3,123
North Addis	5,088
South Addis	3,535
West Addis	32,405
<b>Sub total</b>	<b>44,151</b>
Dire Dawa	46,481
Central- for loan	7
<b>Total</b>	<b>90,639</b>

Source: CBE MIS semiannual report as of December 31, 2015

### **3.4 Unit of Analysis**

The unit of analysis for the research was individuals who are IFB staffs and customers of CBE.

### **3.5 Data Type and Source**

The study has used both primary and secondary data.

#### **3.5.1 Primary Data Source**

The primary data is quantitative and qualitative in nature that was collected from respondent who are IFB customer (depositors and borrower) and staff (line employee, managers and director) of CBE from Addis Ababa and Dire Dawa districts who have dedicated IFB windows.

#### **3.5.2 Secondary Data Source**

In addition to the primary data, secondary data has been used from the bank's report.

### **3.6 Sampling methods and sample size**

#### **3.6.1 Sampling Methods**

It is extremely important to choose a sample that is truly representative of the population so that the inferences derived from the sample can be generalized back to the population of interest. Improper and biased sampling is the primary reason for divergent and erroneous inferences (Bhattacharjee 2012, pp, 66).

By using appropriate sampling techniques which best suites the purpose and situation, sampling has been performed to select representative sample from sampling unit from branch, customer and staff population. This study used multistage sampling techniques-probability and non-probability- to reach at the specific respondents. The districts are selected on a purposive base which we can consider them as strata. Thus, here we have five strata.

#### **3.6.2 Sample Size Determination**

Determining sample size is a very important issue because samples that are too large may waste time, resources and money, while samples that are too small may lead to inaccurate results.

Sample size of branch from the districts and of respondents-customer and staff- have been determined using the following techniques and the detail is presented as follows.

### **I. Branch sample Size**

A method developed by Carvalho (1984) has been used to determine the branch sample size. This sampling technique has been used by Debebe (2015) while determining sample size of bank's branch. The researcher has used bank's December 2015 report to obtain the total branches in these districts and accordingly as of this date there were 83 and 40 branches in Addis Ababa and Dire Dawa districts that have IFB windows respectively which makes the total IFB windows in these districts 123.

**Table 2: Sample Size Determination**

N	51-90	91-150	151-280-	281-500	501-1200	1201-3200	3201-10000	10001-35000	35001-150000
Small	5	8	13	20	32	50	80	125	200
Medium	13	20	32	50	80	125	200	315	500
Large	20	32	50	80	125	200	315	500	800

Source: Carvalho (1984)

Therefore, based on Carvalho sample size determination method the researcher has selected a large sample size which is 32 branches of CBE with IFB windows in Addis Ababa and Dire Dawa districts from the population of 123 bank's branches wherein the larger number is considered to increase the accuracy of the data. Since the number of branches in each stratum is not the same, the researcher has used proportional computation to the size of each stratum, that is to determine the number of branches from each district, the proportion of each district's branch in relation to the total number of branches has been considered. Thus, the numbers of branches from the respective districts have been computed as follows.



**Table 3: Number of Sample Branches from Each District**

District	Branch	proportion	Total Number of branch from respective district
East Addis	23	19%	6
North Addis	18	15%	5
West Addis	30	24%	8
South Addis	12	10%	3
Dire Dawa	40	33%	10
Total	123	100%	32

Source: Own Computation from primary data April 2016

After determining the appropriate number of sample branches from each district, simple random sampling method has been used and 32 branches have been selected to collect data from respondents.

## **II. Customer sample size**

In order to determine number of sample from the population - customer and employees of the bank- a sampling technique called Small Sample Techniques from National Education Association formula has be used (Krejcie & Morgan 1970). This formula has been used by Sahlemariam (2015), Debebe (2015) and Teferi (2015), to determine the representative sample from the population. The formula is:

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

WHERE S= required sample size,  $X^2$ = Table value of  $X^2$  for 1 degree of freedom as the designed confidence level (i.e. 3.8416), N= population size, P= population assumes to be (0.50 since this provide the maximum sample size), d= the degree of accuracy expressed at the proportion (0.05)

Using the above formula, from population of 90,632 IFB deposit customers sample size of 383 have been determined. Since the number of customers in each districts are not the same, the researcher has used proportional computation to the number of customer in each district, that is

to determine the number of respondents in each district, the proportion of each district's customers in relation to the total number of customers have been considered. Thus, the number of respondents from the respective districts has been computed as follows:

**Table 4: Total Number of Customer Sample from Each Branch**

<b>District</b>	<b>Total Number of customer</b>	<b>percentage from total population</b>	<b>Total number of customer sample</b>	<b>Number sample branch</b>
East Addis	3,123	3%	13	6
North Addis	5,088	6%	22	5
South Addis	3,535	4%	15	8
West Addis	32,405	36%	137	3
Dire Dawa	46,481	51%	196	10
<b>Total</b>	<b>90,632</b>	<b>100%</b>	<b>383</b>	<b>32</b>

Source: Own Computation from primary data April 2016

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

### **III. Staff sample size**

Furthermore, the same sample determination technique has been used to determine sample size of IFB staff from the available staff population. The population of IFB staff is 137 and the sample from this population is 102 (87 deposit and 15 credit employees respectively). Questionnaire prepared for the staff have been distributed to the sample branches with equal number of 3 questionnaires for each sampled branches except West Addis district branches where 5 questionnaires for each sampled branches were distributed.

In general, for the purpose of this study the researcher has used Multi stage sampling technique and 383 and 102 IFB customers and staffs have been sampled respectively and data were collected accordingly.

**Table 5: Summery of Sampling Unit, Sample Size Determination and Sampling Technique**

Sampling Unit	Sample size determination	Sampling techniques
Commercial bank of Ethiopia		Purposive
Addis Ababa & Dire Dawa districts		Purposive
Number of branch	Carvalho (1984)	
Branches in each district		Simple random sampling
Number of Branch in each district		Quota sampling
Number of customer in each branch		Quota sampling
IFB Customer	$X^2 NP(1-P)/ d^2(N-1)+ X^2P(1-P)$	Convenient sampling
IFB Staff	$X^2 NP(1-P)/ d^2(N-1)+ X^2P(1-P)$	Purposive

### 3.7 Method of Data Collection

There are two kinds of data sources, primary and secondary sources. This study has used both sources to obtain data. From the primary sources data have been collected through questionnaire and interview. In addition, data have also been extracted from the bank's report. Questionnaires have the advantage of obtaining data more efficiently in terms of researcher time, energy and cost and it is one of the most appropriate data collection instruments for survey research. Moreover, questionnaire, as a data collection instrument facilitates easier coding and analysis of the collected data. The researcher has collected primary data through administering questionnaire and interview. The questionnaire has involved both structured and unstructured questions to collect data from IFB customer and staff. It was prepared to identify the challenges on the delivery and use of IFB. The questions are self developed which the

researcher believed they would answer the research questions. Questionnaire that was distributed to the customer is prepared in Amharic language while for the bank staff it was prepared in English language.

As mentioned above the questionnaire has two parts: close and open ended questions which are meant to collect quantitative and qualitative data respectively. The quantitative data have been collected through close ended questionnaire and bank's report. The close ended part of the questionnaire has been scaled using Likert scale. According to Bhattacharjee (2012), Likert scale is a very popular rating scale for measuring ordinal data in social science research. This scale includes Likert items that are simply-worded statements to which respondents can indicate their extent of agreement or disagreement on a five scale ranging from "strongly disagree" to "strongly agree". Accordingly, the researcher has collected the data by using Likert scale method which indicate the respondents level of agreement or disagreements for the statement with a five point scale ranging from strongly disagree to strongly agree response- Strongly disagree, disagree, Neutral, agree, strongly agree with a numeric value from 1-5 respectively. The open ended questions of the questionnaire part have allowed respondents to give their opinion without any restriction.

The other instrument used to collect primary data from the bank's IFB management team is interview. The interview method of data collection gives an opportunity to clarify any issues raised by the respondent or ask probing or follow-up questions. However, interviews are time consuming and resource-intensive. The researcher has conducted interview through a face to face contact with the respective bank officials to obtain data.

The secondary data have been collected by extracting relevant and supportive data from the bank's report obtained through its database as of December 31 of year 2013 through 2015.

### **3.8 Data Analysis Technique**

The researcher has performed quantitative and qualitative analysis from responses collected on the research questions. Quantitative analysis is statistics driven and largely independent of the researcher. However, qualitative analysis is the analysis of qualitative data such as text data from interview transcripts and open ended question. The quantitative data collected has been

analyzed using statistical tools through descriptive statistics/analysis and presented using tables, and graphs that show the frequencies, percentages and mean values which facilitate the analysis and to make it easily understandable for readers. To assist the analysis of data, Statistical Package for Social Science- SPSS 20 version software has been used. It is a widely used program for statistical analysis in social science. On the other hand, the qualitative data have been summarized and presented to provide information for the raised research questions and also to triangulate some of the response obtained through close ended questions.

## Chapter Four: Data Analysis and Interpretation

### 4.1 Introduction

This chapter presents the results and analysis of data that were gathered from primary and secondary sources through questionnaire and interview. The collected data have been analyzed, and interpreted accordingly. In this study 383 and 102 questionnaires were distributed to IFB customers and employees of the bank respectively. And the entire questionnaires distributed to employees have been collected, however, out of questionnaires distributed to bank's IFB customers 369 (96%) have been collected. And in addition to the questionnaire data was collected through interview and response obtained are summarized and presented accordingly.

**Table 6: Questionnaire Response Rate**

Sample	Distributed		Collected		Uncollected	
	Number	Percentage	Number	Percentage	Number	Percentage
Customer	383	100%	369	96%	15	4%
Staff	102	100%	102	100%	0	0%

Source: Own Computation from responded questionnaire, April 2016

### 4.2 Characteristics of respondents

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

The study has two types of sample and each sample further divided in to two sub samples. The basic samples are bank's employee and customer. The employee sample constitutes two samples which are employee sub sample of credit department and employee sub sample of

branch. And also the customer sample constitutes two sub samples of financing and deposit customer. Thus, the analysis was conducted based on this classification. The reason for such further division of each sample category is that, there is difference in the type and nature of the products (dealing with fund mobilizing products and the other fund utilizing products), where the service is being provided and staffs handling the work vary significantly.

**Table 7: Characteristics of Sample Customers**

Demographic Characteristic	Outcome	
	Frequency	Percentage
<b>Religion</b>		
Muslim	354	96.2%
Non-Muslim	14	3.8%
Total	368	
<b>Banking relationship- As a whole</b>		
Less than one year	47	12.75
1-3 year	117	31.7%
3-5 year	97	26.35
>5	94	25.5%
Total	355	96.2%
<b>IFB relationship</b>		
Less than one year	103	27.9%
1-2 year	212	57.5%
2-3 year	38	10.3%
Total	353	

Source: Own Computation from Primary Data Source, April 2016

Table 7 shows that 96.2% of IFB customers are Muslim and the rest 3.8% is non-Muslim which shows the bank's majority IFB customers are Muslim. When we look at the characteristics related to years of banking relationship as a whole, 12.7% have less than a year relationship which tells these customers have started banking relationship after the introduction of interest free banking that witnessed IFB is calling for those who waited for its services. 31.7%, 26.3% and 25.5% represented banking relationship fall between 1-3, 3-5 and more than 5 years of banking relationship respectively. In addition to this 27.9%, 57.5%, and 10.3% of respondents

have IFB banking relationship of up to 1, 1-2, and 2-3 years respectively. Thus, as their experience seems satisfactory, we can use the response obtained from these respondents as matured for the conclusion of this research work.

**Table 8: Characteristics of Sample Staffs**

Demographic Characteristic	Outcome	
	Frequency	Percentage
<b>Job position</b>		
Line staff	95	94.1%
Management	6	5.9%
Total	102	
<b>Qualification</b>		
Masters	5	5%
BA degree	93	91%
Diploma	2	3%
Total	102	
<b>Banking experience- As a whole</b>		
<5 year	32	32.3%
6-10 year	43	43.4%
>11 year	24	24.24%
Total	102	
<b>Banking experience- IFB</b>		
Up to 1 year	53	52.5%
1-2 year	30	28.7
2-3 year	14	13.9
Total	97	

Source: Own Computation from Primary Data Source, April 2016

Table 8 shows that 94.1% (95) are line staffs who have direct contact with customers and 5.9% (6) are management member. Majority of the staff have BA degree that constitutes 92% and 5% with Masters Level of qualification where 67.7% having above six years of banking experience. However, 52.5% of IFB staff has less than one year IFB experience and 28.7% have work experience above one year but less than two years. Generally, the data tells us that



respondents who have participated in the study constitute both management and line staffs that have direct contact with customers and real work experience and which could provide the ups and downs of IFB issues. Thus, data obtained from them would be fair enough to draw reasonable conclusion.

### 4.3 Reliability Test Statistics

Reliability is the degree to which the measure of a construct is consistent or dependable. It implies consistency but not accuracy (Bhattacharjee, 2012). The most popular test of internal consistency is the Cronbach's alpha. The higher the coefficients, the better the measuring instrument (Sekaren, 2003). According to Hair, et al., (2006), if  $\alpha$  is greater than 0.7, it means that it has high reliability.

**Table 9: Reliability of Statistics (Test): Deposit Customers**

Item	Cronbach's alpha	Item	valid case
Demand for IFB products	0.794	3	6
Capacity of the bank to delivery IFB products	0.791	5	345
Awareness about IFB products	0.747	7	369

Source: Output of SPSS, April 2016

**Table 10: Reliability of Statistics (Test): Deposit Staffs**

Item	Cronbach's alpha	Item	valid case
Demand for IFB products	0.924	3	82
Capacity of the bank to delivery IFB products	0.717	6	86
Awareness about IFB products	0.775	7	87

Source: Output of SPSS, April 2016

**Table 11: Reliability of Statistics (Test): Credit Customers**

Item	Cronbach's alpha	Item	valid case
Demand for IFB products	0.839	3	6
Capacity of the bank to delivery IFB products	0.796	5	6
Awareness about IFB products	0.799	11	6

Source: Output of SPSS, April 2016

**Table 12: Reliability of Statistics (Test): Credit Staffs**

Item	Cronbach's alpha	Item	valid case
Demand for IFB products	0.751	9	15
Capacity of the bank to delivery IFB products	0.710	6	15
Awareness about IFB products	0.887	11	15

Source: Output of SPSS, April 2016

For internal consistency test, Cronbach's alpha model of testing have been employed and for the customer and staff instrument the result obtained showed Cronbach's alpha coefficient above 0.7 which indicates it is highly reliable.

In the following part of this chapter analysis conducted for each research questions based on the result obtained on the data collected and tools employed has been presented.

#### **4.4 Status of IFB in CBE**

To assess the current status and the extent of utilization of IFB products in CBE, secondary data have been extracted from the bank's internal sources –report which shows the utilization of IFB products from its introduction to date. Currently, the bank provides the deposit related IFB banking services in its selected branch throughout its 15 districts while the credit or fund utilization product has only been availed in its head office. Three years data that is from year 2013-2015 have been used to examine its performance in terms of IFB fund mobilized and utilized, IFB customer base, and number of interest free banking window (IFBW).

##### **4.4.1 Interest Free Banking Windows (IFBW)**

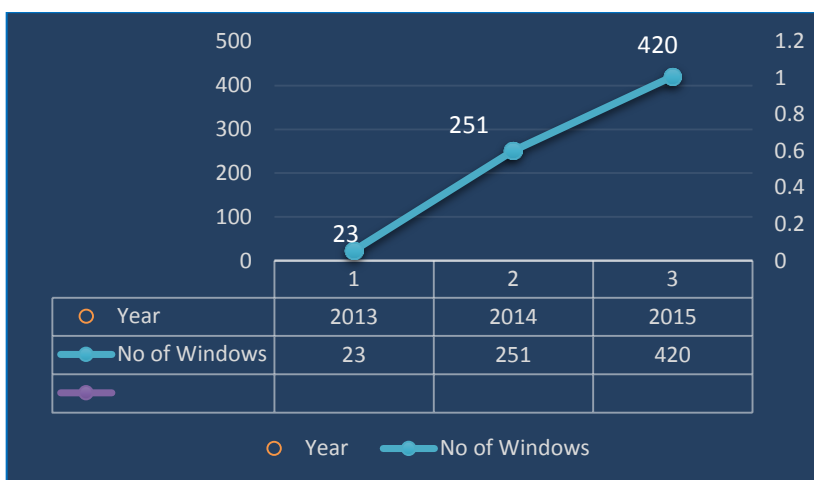
National bank of Ethiopia has authorized IFB business to be undertaken through window model. Basing this, CBE has initially started its IFB operation in its 23 IFBW wherein the current IFBW have reached 420. The following table and figure shows its trend from the first year of operation to date.

**Table 13: Interest Free Banking Windows (IFBW)**

Year	Number of IFBW	Growth rate
2013	23	-
2014	251	991%
2015	420	67%

Source: CBE MIS report December 31, 2013, 2014 & 2015

**Figure 1: Performance of IFBW**



As the above table and figure show, IFBW has increased significantly in year 2014 but it has increased at a decreased rate in year 2015. Out of the total number of 1,006 branches 420 of them have IFBW. This shows us that though its windows are increasing from year to year it is still providing IFB products in its 42% of the branch. Since window is one of the major facilities to provide IFB products its availability at the customers' convenience and adequacy determine the utilization of the window's/IFB services. So, the windows coverage shall address the available demand for IFB services.

#### 4.4.2 IFB Deposit Mobilization

The bank has availed three IFB deposit mobilizing products to its customer through its available windows out of the four renowned products. These products were open for utilization since the introduction of IFB. The detail of the utilization since its inception is tabulated as follows.

**Table 14: IFB Deposit Product Utilization**

<b>Year</b>	<b>Products availed and Used By the Customer</b>	<b>Customer Base</b>	<b>Fund Mobilized</b>
2013	Amanah	No data obtained	17,724,081
	Qard	No data obtained	13,078,354
	Mudarabah	No data obtained	8,599,383
	<b>Total</b>		<b>39,401,818</b>
2014	Amanah	35,844	403,428,557
	Qard	763	48,858,844
	Mudarabah	2,034	39,111,783
	<b>Total</b>	<b>38,641</b>	<b>491,399,184</b>
2015	Amanah	199,412	1,864,198,435
	Qard	1,779	224,473,148
	Mudarabah	3,215	58,481,297
	<b>Total</b>	<b>204,406</b>	<b>2,147,152,880</b>

Source: CBE MIS report December 31, 2013-2015

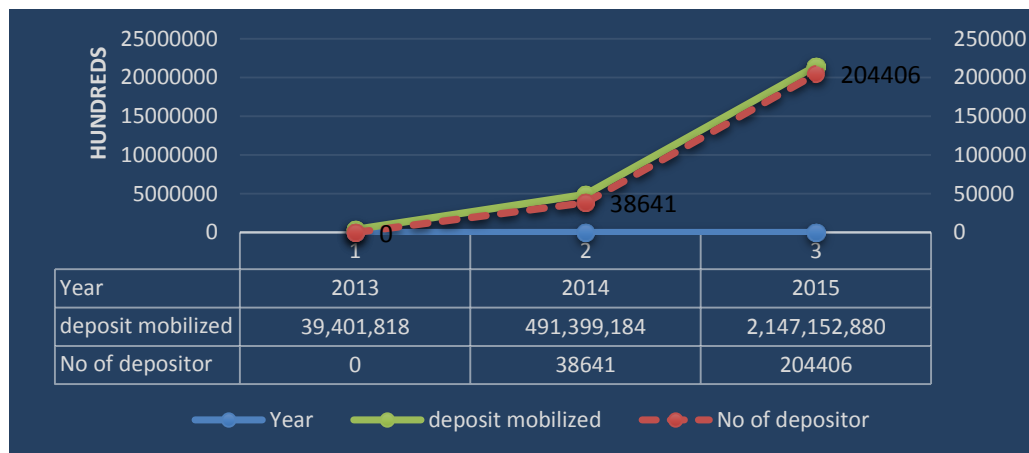
Fund mobilized through the above cited products have been increasing significantly every year. It is not only the fund amount that is increasing but also its customer base that indicates the availability of demand for IFB deposit products. Among the availed products, Amanah is being utilized significantly as compared to the other types, followed by Qard and Mudarabah. The following table shows both the overall utilization of IFB deposit products in relation to fund mobilized and its customer base.

**Table 15: Performance of Fund Mobilized and Customer base**

<b>Year</b>	<b>Customer Base</b>	<b>Fund Mobilized</b>	<b>Increase In Customer Base</b>	<b>Increase In Fund Mobilized</b>
2013	Data not obtained	39,401,818	-	-
2014	38,641	491,399,184	-	1147%
2015	204,406	2,147,152,880	429%	337%

Source: own computation from secondary data April 2016

**Figure 2: The Performance of Deposit Mobilized and Customer Base**



The above table and figure shows that fund mobilized and customer base of IFB deposit products are increasing significantly. However, there is an indication that has signaled the utilization of IFB deposit and customer base would have been more than the current one. This indication is the continuous increase in fund mobilized through special demand deposit (SDD) and increase in its customer base, which was expected to decline or ceased to exist after the introduction of IFB in the country.

### ➤ **Special Demand Deposit (SDD)**

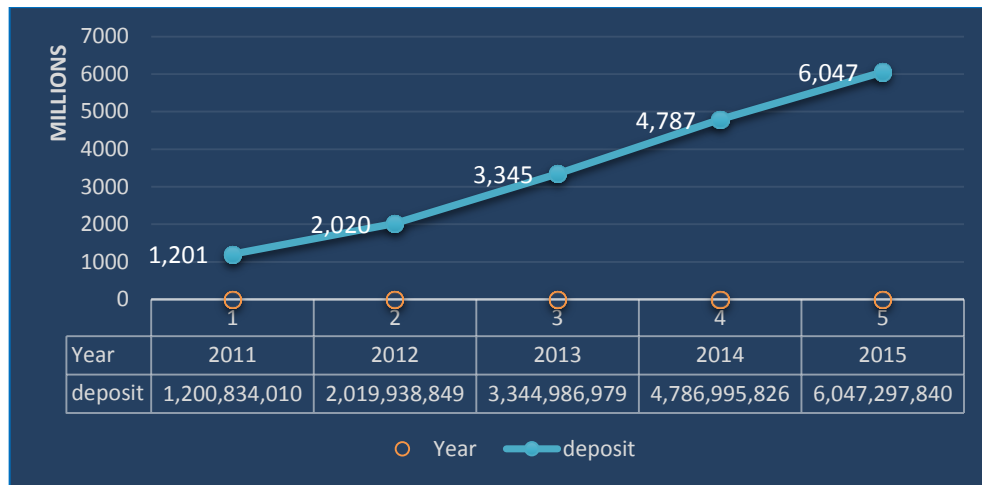
Prior to the introduction of IFB, the bank has availed Special Demand Deposit (SDD) which is deposit mobilizing products that does not pay interest for the deposited money. This product is aimed to serve those customers who do not like to earn interest on their savings. The only similarity between IFB deposit products and SDD is that both products do not pay interest on the saved money. However, the major difference is that unlike IFB, SDD does not comply with Shariah law and principle that the Muslim community would like the financial products to governed by. It is totally natural to expect the decline or closure of this account upon introduction of IFB deposit products. However, instead of declining in terms of customer base and fund mobilized, it is increasing every year. In the following table and figure the past five year SDD performance has been illustrated.

**Table 16: Five year Performance of SDD account**

Year	Amount	Growth in percentage
2011	1,200,834,010	-
2012	2,019,938,849	68%
2013	3,344,986,979	66%
2014	4,786,995,826	43%
2015	6,047,297,840	26%

Source: CBE MIS report December 31, 2011-2015

**Figure 3: SDD performance for the past five year**



The above table and figure shows that SDD account performance has exhibited an increasing trend contrary to the expectation. As per the explanation of the bank's officials and data obtained from open ended question the reason for this unexpected result is due to awareness problem of customer about presence of IFB and Problem related with non availability of IFBW in all branches.

Thus, problem related to awareness and the service being limited to certain branches have an effect on the utilization and growth of IFB business. When we see the situation at face value it seems it would have no effect for the bank as the net effect does not reduce the intended deposit whether its being through IFB or SDD, but especially the Muslim community clearly know that SDD does not meet its banking needs as it is not Shariah compliant product. Thus, this community especially those who held this belief may not come to the banking system.

### 4.4.3 IFB Fund Utilization

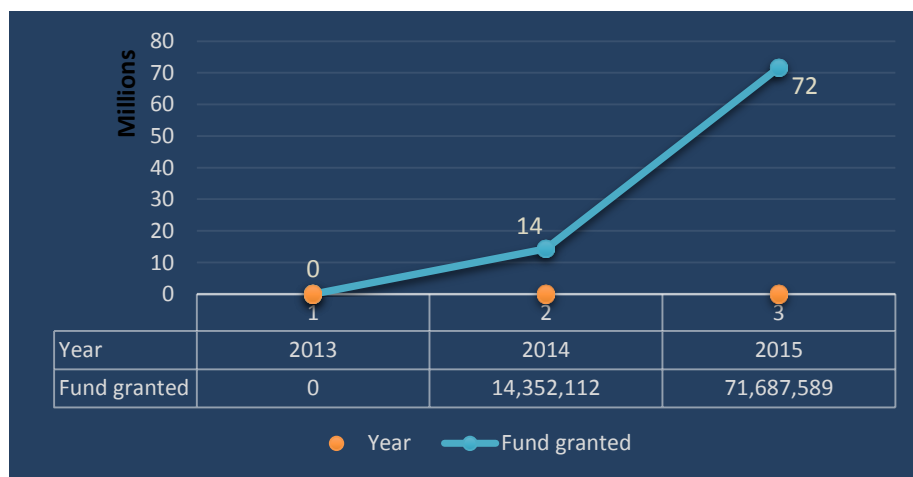
The other product that the bank has availed to its customer is IFB financing product. At present, the financing product that the bank provided to the market is Murabaha financing. The following table and figure shows the utilization of the Murabaha account since its introduction.

**Table 17: IFB Financing Product Utilization**

Year	Products Aailed And Used	Customer Base	Amount Disbursed
2013	Murabaha	-	-
2014	Murabaha Murabaha	3	14,352,112
2015	Murabaha	7	71,687,589

Source: CBE MIS report December 31, 2013-2015

**Figure 4: IFB Financing Product Utilization**



From internationally renowned and major IFB financing products –like Mudaraba, Murabaha, Musharaka, Istisna, Ijarah, Salam- the bank has availed Murabaha financing. It is a sales type of contract which is the simplest of all the contract types. The utilization of IFB financing is not like the deposit. Currently, using this product type the bank has availed insignificant fund as compared to fund mobilized (deposit as of December 31, 2015 was birr 2,147,880 while loan amount was birr 71,687,589- CBE MIS report December 31, 2015). This shows that the available financing product is not being utilized effectively, for instance in year 2015 fund

utilized as compared to mobilized is only 3%. The reason for such poor performance has to be identified so as to set workable strategy.

The main role of bank is to play as a financial intermediary by mobilizing fund through saving and utilizing the mobilized fund by investors through financing products that the bank provide for the market. If the mobilized fund not being utilized by the investor the economic development role that is expected to be played by banks may not be achieved. It can also be observed from the above data that there is huge idle fund that has created excess liquidity that calls for best and effective utilization. This will be materialized by the bank through developing a variety of IFB financing products/services that meets its customer need, promoting the existing one and work within and outside the bank to create an environment that would enable the best delivery and utilization of IFB products/services.

To sum up the above points among the four theoretically available fund mobilizing product type the bank has availed three of them and also the deposit products utilization has shown satisfactory utilization as compared to financing product. According to the available data the utilization for deposit products could have been better than this had problem related to awareness and limited IFBW have not challenged the utilization of these products. However, the financing part of IFB is not good both as to the provision of products and even the utilization of the available one. The bank has provided Murabaha financing and which has been utilized only by very few customers with insignificant loan amount as compared to deposit. Based on the assessment of the secondary data the following issues have been identified:

- Only 42% of its branches have IFBWs.
- Limited utilization of Mudaraba (unrestricted investment) saving account.
- Limited utilization of Murabaha financing product
- Only Murabaha type of IFB financing product and
- A continuous increase in SDD account is an indication that the saving mobilized through IFB products with its customer base would have been more than the current utilization level.



## 4.5 Demand for IFB products

One of the research questions raised by the researcher is about the level of demand for IFB products other than the currently provided one. The purpose of asking this question is to get answer for the current provision of some of the product types is due to lack of demand for the other types products/services or not. Thus, to meet this objective data have been gathered from customers through close and open ended questions. In addition to this, data have also been obtained from staff (both credit and deposit) and bank officials to triangulate the response obtained from the customer. The collected data have been analyzed and produced the following result.

### 4.5.1 Deposit Customers and Staffs Response

The result obtained from IFB deposit customer and staff showed that the currently availed IFB deposit products are based on the current demand and satisfy their need but there is low demand for the other (not available) types of IFB deposit products. The detail of the results from both samples is tabulated as follows:

**Table 18: Deposit Customers Response about Demand**

<b>Demand Item</b>	<b>Strongly agree</b>	<b>Agree</b>	<b>Neutral</b>	<b>Disagree</b>	<b>Strongly disagree</b>
The existing IFB deposit products are based on current demand	14.4%	37.7%	23%	11.1%	12.7%
The current IFB deposit products is what you really want	18.4%	37.9%	17.6%	15.2%	10.6%
There is no demand for IFB deposit products other than the existing one	16.3%	23.9%	27.8%	23.6%	8.4%

Source: Own Computation from Primary Data Source, April 2016

The above table show that, based on the sample deposit customer response about demand for the other type of IFB product, 52% of respondents have agreed (strongly agree and agree) that the current IFB deposit products are based on the current demand; furthermore 56.3% agreed (strongly agree and agree) that it satisfy their need. Moreover, 40.2% of them agreed about the non existence of demand for the other types of IFB deposit product which the bank currently

not providing, however, 32% disagreed (strongly disagree and disagree) and 27.8% being neutral.

**Table 19: Deposit Staffs Response about Demand**

<b>Demand Item</b>	<b>Strongly agree</b>	<b>Agree</b>	<b>Neutral</b>	<b>Disagree</b>	<b>Strongly disagree</b>
The existing IFB deposit products meets the current demand of its customer	12.6%	48.4%	12.6%	13.7%	3.2%
The availed IFB deposit products are what the customer really need	17.9%	31.6%	21.1%	17.9%	1.1%
There is no demand for other types of IFB deposit products	8.4%	50.5%	16.8%	12.6%	1.1%

Source: Own Computation from Primary Data Source, April 2016

Table 19 shows, from IFB deposit staffs sample, 61% of respondents have agreed (strongly agree and agree) that the existing IFB deposit products meets the current demand of the customer and 58% agreed (strongly agree and agree) that there is no demand for the other types of IFB deposit products. Moreover, 49.5% of respondents agreed that the availed products are what the customers really need. In addition to the above data, response obtained through open ended question further confirms the above situation, that is majority of respondents said that there is no demand/ request for additional IFB deposit products from customers.

Moreover, the descriptive statistics result shows that the mean score of demand for other IFB deposit products based on the response obtained from customer and staff is 3.21 and 3.13 respectively. Given the questionnaire and employing the midpoint mark of 3.00, the current available IFB deposit products are based on the current demand and satisfy the current customer needs. Moreover, there is no demand for the other type of IFB deposit products.

#### **4.5.2 Sampled Financing Staffs and Customers Response**

Questionnaire has been prepared and distributed to collect data from credit staff and customer. The prepared questionnaire have both close and open ended question. The total population of financing staff is 15 and credit customers are 7. As their numbers are few the whole population has been surveyed.

### A. Financing customer response

Interest free banking credit customers of the bank are very few that is the bank has only 7 IFB financing/credit customers. Their responses for the given statements are summarized as follows.

**Table 20: Credit Customer Response about Demand**

<b>Demand Item</b>	<b>Strongly agree</b>	<b>Agree</b>	<b>Neutral</b>	<b>Disagree</b>	<b>Strongly disagree</b>
The bank is providing IFB credit products that meet the current demand of its customer.	0%	66.7%	0%	33.3%	0%
There is no demand for IFB credit products other than the currently availed one.	0%	0%	0%	50%	50%
The bank has availed the type of IFB credit products that are really needed by the customer.	0%	100%	0%	0%	0%

Source: Own Computation from Primary Data Source, April 2016.

Table 20 shows that 66.7% of respondents have agreed that the available IFB credit product meet the demand of its customer however, 33.3% disagreed .And 100% of them have agreed it has satisfied their need. However, 50% of the respondents strongly disagreed and 50% are also disagreed for the non availability of demand for other IFB financing products. Moreover, the descriptive statistics result showed that the mean score for the above demand response is 3.39 which showed that there is demand for the other types of IFB credit products.

### B. Financing staff response

Questionnaire with nine items about the current demand for IFB financing products and demand for individual IFB products have been prepared to gather data from IFB financing staff. The result obtained is summarized as follows:

**Table 21: Result from financing staff response**

<b>Demand Item</b>	<b>Strongly agree</b>	<b>Agree</b>	<b>Neutral</b>	<b>Disagree</b>	<b>Strongly disagree</b>
The bank is providing IFB credit products that meet the current demand of its customer.	0%	13.3%	40%	46.7%	0%
The bank has availed the type of IFB credit products that customers'' really need.	0%	20%	33.3%	33.3%	6.7%
There is no demand for IFB credit products other than the currently availed ones	0%	13.3%	46.7%	40%	0%
Customers request more frequently Mudarabah financing product	26.7%	46.7%	20%	6.7%	0%
Customers request more frequently Murabaha financing product	26.7%	53.3%	20%	0%	0%
Customers request more frequently Musharaka financing product	13.3%	46.7%	33.3%	0%	6.7%
Customers request more frequently Istisna financing product	0%	13.3%	66.7%	13.3%	6.7%
Customers request more frequently Ijarah financing product	0%	20%	66.7%	13.3%	0%
Customers request more frequently Salam financing product	6.7%	20%	53.3%	6.7%	13.3%

Of the total IFB credit staff respondents, 46.7% disagreed that the existing IFB financing product meets the current demand of its customer; furthermore the agreement level is only 13.3%. In addition, 40% of respondents disagreed that there is no demand for other types of IFB financing products while the agreement level is only 13.3%. Moreover, for statement about the availed IFB financing product is what customer really need 40% of respondents disagreed and only 20% agreed. 40% of respondents neither agreed nor disagreed regarding the present demand. Thus, according to the response obtained from IFB credit staff of the bank the current financing product is not based on the current demand and it is not the product that customer really need. Furthermore, there is demand for the financing products which currently the bank not providing. Moreover, the descriptive statistics result shows that the mean score for the

demand of IFB other financing product is 3.24 that shows the existence of demand for the other (non-availed) types of IFB financing products. The table below show demand/request from customer for each type of IFB financing product.

**Table 22: Result from IFB Credit Staff about Products**

Item	Murabaha	Mudaraba	Musharaka	Istisna	Salam	Ijarah
Respondents Agreement level based on the customer request for product type	80%	73%	60%	27%	27%	20%

Source: Own Computation from Primary Data Source, April 2016

The above table shows that there is demand for all IFB financing products through the degree of request differ from product to product. There is high request for Murabaha, followed by Mudaraba and Musharaka financing product.

Response obtained through open ended question further confirms and support the above results. IFB financing product type that is requested by customers other than the already availed one are: Mudaraba, Ijara, Musharakah, Istisna, and Salam. This shows us that there is demand for IFB financing products though the bank has availed only one type of financing product.

The above result showed that the available IFB deposit products are based on the current demand and satisfy their need. However, there is demand for IFB financing products other than the currently provided one. Thus, this result confirms that the limited provision of IFB financing product is not due to lack of demand for the products.

#### **4.6 Customers Awareness about IFB Products.**

The other research question that this study aimed to answer was customer awareness about IFB products. Awareness problem has been identified as one of the major challenges by several researchers that have negatively affected the utilization of IFB products. Thus, to meet this objective data have been gathered from customers through close and open ended questions. In addition to this, data have also been obtained from staff (both credit and deposit) and bank officials to triangulate the response obtained from the customer. The collected data have been analyzed and produced the following result.

Customers' awareness matters a lot for a successful consumption of any product. In this study to measure the level of customers' awareness about IFB and its products, closed ended questions through questionnaire for the customer and staffs have been distributed. Questionnaire includes general and specific question with eleven items that required level of agreement or disagreement for each statement.

**Table 23: Result of Customer Awareness about IFB Products.**

Response for ' customer has awareness about IFB products' of	Strongly agree	Agree	Neutral	Disagree	Strongly disagree	Awareness Mean score
deposit customer	0%	10%	59.9%	24.9%	5.1%	2.74
Credit Customer	0%	50%	33.3%	16.7%	0%	3.33
Deposit staff	1.1%	13.7%	45.3%	29.5%	2.1%	2.73
Credit staff	0%	0%	66.7%	26.7%	6.7%	2.58

Source: Own Computation from Primary Data Source, April 2016

Table 4 shows except for credit customer response about IFB products awareness majority of respondents are neutral and the next rate goes to disagreement response. Furthermore, the mean score for deposit customer awareness level is 2.74 while credit customers' awareness level is 3.33. Given the questionnaire and employing the midpoint mark of 3.0, the result indicate that the IFB deposit customer have low awareness about IFB products while credit customer have awareness about IFB product. Further, to triangulate the result staff (deposit and credit) have been requested about the customer s' level of awareness about IFB and its products and the collected data have been analyzed and produced a mean score of 2.73 and 2.58 which is below the midpoint mark of 3.0, that further confirms the low level of customer awareness about IFB products. Thus, this result confirms that IFB customers have awareness problem which is a foundation to utilize IFB products.

In addition to this, in an effort to collect data on challenges of IFB, both customer and staff have cited customer awareness problem as one of the major challenges to use IFB products.

## 4.7 Capacity of the bank to provide IFB products

The survival of any business in the market highly depend on its capacity to deliver its products or services to its customer. Capacity in this study means resources which are necessary to provide the required products or services to customers which include human resources to develop, promote and deliver IFB products- adequate, knowledgeable and experienced manpower- and infrastructure- related to IT and adequate window. Questionnaires for both IFB customers and staffs have been prepared to get their opinion about the bank's capacity to deliver IFB products/services. The collected data have been analyzed and presented in the table below.

**Table 24: Result for capacity to deliver IFB products**

Item	Mean
Knowledgeable manpower	2.666
experienced manpower	2.878
Infrastructure-IT	3.119
skill to develop IFB products	2.923
Knowhow to promote IFB products	2.816
Convenient branches, windows & services quality	2.6436

Source: Own Computation from Primary Data Source, April 2016

According to the data collected from the staffs and customers the average mean score for bank's capacity to deliver IFB products/services is 2.83 which is below the midpoint mark of 3.0. This result showed that the bank does not have the capacity to deliver full range of IFB products/services to its customer. The considered parameter to assess its capacity turnout with a negative response that is the bank's human resources are not well trained, skilled and experienced. Moreover, the services provided by the bank are not in a convenient branch with expected service level. However, the bank has the necessary infrastructure to undertake IFB business.

In addition to response obtained from the closed ended questionnaire, the researcher has gathered data through open ended question that showed the bank's human resource at present lacks knowledge, not competent enough to satisfy customers, and also inexperienced and

inadequate in number to serve customer. Moreover, since the bank did not start to give IFB in all of its branches this has created inconveniency on customers to use IFB services and there is also shortage of window within the branch which made customers to wait long till they get served.

#### **4.8 Limited Type of IFB Products**

One of the major focus areas of this research for which the researcher aimed to get an answer was about the current provision of IFB especially financing product. From the bank's sources, the researcher has identified that the bank is currently, providing limited IFB financing product as compared to the internationally renowned major IFB products. To identify reasons for why the product is limited, the researcher has made an interview with the bank officials (Director and Manager IFB department) and the response is summarized as follows.

According to the officials, the challenges which have forced the bank to limit its product are:

- Lack of the required preparedness of the bank to deliver the other type of IFB financing product. The nature of some of the product type requires the involvement of the bank in activities which are completely different from the nature and experience of the banking business. It requires the bank to have a well diversified skill and knowledgeable staff and facilities like expert in different fields like construction, purchasing, leasing, and managing and warehouses, and other fixed assets which currently the bank did not have.
- Lacks of relevant experience on the job as IFB business is new to the bank even to the country.
- Lack of Shariah advisor which confirms the products and every transaction of the bank is in line with the Shariah requirement.
- Lack of commitment to provide IFB products.
- Lack of risk management mechanism has led the bank to avoid some of IFB products which has high risk level.
- Due to its nature, one of the ideal types of IFB products-Musharaka- which is based on partnership agreement require the bank to have share in the business wherein NBE directive (SBB/12/1996) has set limit as to the bank's share on other type of business activity. As a result of this directive it is difficult to provide Musharaka financing



product. In addition to this IFB directive SBB/51/2011, does not provide adequate and detail guidance for the bank as to the product development and delivery and other important issue for which the bank wants to refrain from being involved heavily in the IFB business.

- The country's tax system, IFB involves buying and selling transaction which resulted in double taxation. In IFB cash is not directly given to the borrower rather the bank purchase the asset, and own it after that it can sale to the borrower. These transactions entail two times tax payment. First the bank pays when it purchases it and the borrower pays when he/she re-purchases it from the bank. This will have an effect on the cost of products that are financed through IFB that makes IFB product user less competitive.

Generally, lack of preparedness, commitment, and relevant experience on the job, Shariah advisor and risk management mechanism are internal problem of the bank and the existing regulatory and tax system can be considered as external challenges which both hinder the delivery of the other types of IFB financing products. Thus, due to these problems the bank has selected to start with the simplest and less risky type of IFB products- Murabaha- though there is request for the other types of IFB products/services.

#### **4.9 Challenges of IFB products/Services**

The main objective of this research was to identify the challenges that commercial bank of Ethiopia has faced while providing IFB products and also the challenges that customer has faced to utilize IFB products. Thus, this was set as one of the research questions to sought answer for. Both customers and staffs- line and management- of the bank have been requested about the challenges of IFB products/services that they have faced. Accordingly, they have identified challenges which hindered IFB products from being delivered and utilized by the bank and customers respectively. The researcher has summarized the identified challenges as follows.

### **4.9.1 Challenges to Deliver IFB Products**

Data have been collected from both staffs and customers of the bank and the obtained data have identified the following challenges.

#### **I. Lack of commitment of the bank**

As a new business IFB should be given the necessary attention and support from all stakeholders to stand and succeed in the business. However, according to response obtained from bank's staffs and customers IFB is not being supported and given the necessary attention as it demanded from the bank as a service provider.

#### **II. Lack of Shariah advisor**

According to the bank's officials, currently the bank does not have Shariah advisor. Shariah advisor/board is mandatory requirement to undertake IFB business. There is problem of getting well educated and qualified person in Shariah as well as business knowledge. According to Pasha (2014) IFB shall comply with Shariah law, which means bank's products and services and even its transaction and business activity has to be in line with the principles and law stipulated in Shariah. This confirmation of bank's activity is executed by the Shariah advisors which currently the bank did not have. Thus, the non availability of Shariah advisor has been cited as one of the major challenges by respondents which have affected the bank not to develop and deliver IFB products as this process requires the committee's approval and confirmation.

#### **III. Lack of supportive supervisory directive**

According to the response obtained the current supervisory directive has challenged the delivery of IFB products. For instance, one of the directives is in direct conflict with prospective IFB product offering and does not consider the nature and requirements of IFB operation. The supervisory body's directives is the same for both the IFB and the conventional banking except related to interest rate. According to Article 3 of limitation on investment of bank, directive SBB/12/1996, "A bank may hold shares in a non-banking business only up to 20% of the company's share capital and total holdings in such business shall not exceed 10%".

This article creates a conflict for issuing Musharaka financing partnership agreement in which a bank could own majority of the share of a business/transaction at the time of the signing of the contract. Thus, this directive hinders the delivery of this product at all. In addition to this the IFB directive does not give detail guide line and there is also weak support and follow up from NBE.

#### **IV. Problem related to Ethiopian Commodity Exchange (ECX) law**

Commodities purchased from ECX floor cannot be sold locally. Which means the bank cannot buy and sale commodities for its export customer by providing Murabaha financing. This is also the major problem for the under utilization of the existing Murabaha financing.

#### **V. Lack of Capacity to deliver IFB products at full capacity**

According to the respondents, the bank manpower is inadequate in number, not well trained and inexperienced to undertake IFB business. Lack of well trained personnel and well versed with both theory and practice of interest-free banking is serious problem to deliver IFB products/services. In addition to this it did not devised risk management mechanism rather the bank has just avoided the provision of the other type of IFB products due to the high level of risk, further the assigned windows are inadequate to serve its customers.

### **4.9.2 Challenges to Use IFB Products**

Data which have been collected from the sample respondent have identified the following challenges that customer faces to utilize IFB products.

#### **I. Lack of Awareness about IFB products from customers**

According to data gathered from customers and staffs, customers lack awareness about IFB products. Generally, users do not know the types of IFB products and their rules and regulations. This fact is also confirmed through the quantitative data gathered from customers and staffs that there is awareness problem. Awareness problem sets serious challenge on the success of IFB product utilization. The secondary data obtained related to SDD showed the existence of awareness problem about IFB products/services and not knowing the difference

between SDD and IFB. Awareness problem has also been identified as one of the major challenges by Jabr (2003), Saleh and Zeitun (2005) and Bello & Abubakar (2014) Palestinian, Lebanon and Nigeria.

## **II. Inadequate marketing and promotion**

The respondents have identified the weak marketing and promotion conducted by the bank has indirectly and negatively affected the utilization of IFB products. The marketing and promotion was not done to help the products to be known by the public.

## **III. Double taxation**

Double taxation refers to the tax that would be levied on Islamic banks as a result of stamp duties that is payable upon asset transfer. IFB operation involves buying and selling transaction of asset which entails tax payment. The bank has to initially own the asset and sale same to the customer. Thus while owning the asset by the bank, it will pay tax and when it sale to its customer the buyer pay tax. As a result of this buying and reselling of asset, double taxation occurs. Thus, this is one of the major challenges to use IFB.

## **IV. Nature of IFB products**

The principles of IFB does not allow the direct receipt of cash as financing rather the cash is used directly for the asset to be purchased in the name of the bank and later the bank will sale the asset to its customers. Such practice is unfamiliar to both the customer and the bank which has created inconvenience and problem. In addition to this, in case where finance for working capital which directly require the involvement of cash, for example payment for laborers, for the service providers and etc the problem worsen. The bank has not devised mechanism to entertain such issues as the international experience did. Thus, this has created challenge to utilize IFB products. Kinyanjui (2013) has identified nature of IFB products as one of the major challenges which has created problem in effective delivery and use of IFB products in Kenya.

## **V. Unavailability of IFB products/services in all of its branches**

According to the secondary data obtained from the bank, it is currently providing IFB services in its selected branches and the financing products are processed centrally unlike its

conventional structure. This has created accessibility problem to utilize IFB products at customers' convenience. The structure of the financing process deters those customers living in outlying districts to present their financing request to the bank as the financing is entertained at head office found in Addis Ababa. Moreover, not all products are also available in those branches that have started IFB services. This has created accessibility problem to the customer to easily utilize the existing one too. Thus, lack of IFBW has created inaccessibility of IFB products which has been cited as challenge to use IFB products.

#### **VI. Being Window model**

Internationally, IFB services are being provided through different model that range from full-fledged Islamic banks to a window model in a conventional bank. However, all of the models have their own acceptance level from the customers' side. Currently, IFB products in Ethiopia are being delivered through a window model which has created inconveniency and has affected the customers' trust negatively. Majority of the customer would like to obtain IFB service on a branch model.

#### **VII. Lack of trust and confidence**

According to the responses obtained from the sample, customers lack trust and confidence as to the bank's capacity and commitment to deliver Shariah compliant IFB product and services. Per the response customers believed that there is mixing of IFB and conventional banking transaction and the bank is not even committed to give truly IFB services this has eroded the customers' trust. And it is cited as the major challenge that has hindered IFB products from being utilized. Kinyanjui (2013) has identified this as one of the major challenges for IFB in Kenya.

To sum up the findings on major challenges to deliver and use IFB products are: lack of awareness about IFB products from customer, inadequate marketing and promotion, double taxation, nature of IFB products, inaccessibility of IFB products, the IFB being delivered in a Window model, lack of trust and confidence, non availability of other services attached to the products, lack of commitment and focus from the bank, lack of Shariah board, lack of supportive supervisory directive, problem related to Ethiopian Commodity Exchange (ECX) law and lack of capacity to deliver full range of IFB products.

## **Chapter Five: Conclusion and Recommendation**

### **5.1 Introduction**

The main objective of this study was to identify challenges that banks face to deliver Interest free banking products and also to utilize these products by customers. In addition to its main objective, the current status, demand, and bank's capacity to deliver and users level of awareness about IFB products have been examined. Based on the collected data and analysis work, this part provided the conclusions drawn from analysis results and possible recommendations of the researcher.

### **5.2 Conclusion**

Conclusions which have addressed the objectives of the study have been drawn from the analysis results. Based on this, the findings of the study are presented as follows:

- Customers use deposit and financing IFB products that the bank has availed. From the deposit products Amana has been utilized significantly while the utilization of Qard and Mudaraba products is not notable as compared to Amana account. The bank's deposit performance outperformed the financing product and has created excess liquidity. The current IFB deposit side has more funds available for financing IFB loans. The bank has granted loan which is insignificant as compared to the mobilized deposit though there is demand for IFB financing products which is a means to utilize the excess fund. That is the available financing products- Murabaha- is not being utilized as expected. It has a very few customer with insignificant loan amount. Thus, the extent of utilization of IFB in terms of deposit products can be said satisfactory as compared to the financing one. The 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, lack of trust and confidence.

- There is low demand for the other type of IFB deposit products. However, the analysis result obtained from the response of financing/credit customer and staff indicated that there is demand for the unavailed IFB financing product types.
- The result obtained from the customers and staffs have showed that there is awareness problem about IFB and its products.
- Based on the result obtained, there is capacity problem to deliver full range of IFB products/services to its customers as the considered parameters to assess its capacity turnout with negative responses.
- Challenges that have constrained the bank to limit its IFB especially its financing product are, lack of preparedness, commitment, relevant experience on the job, Shariah advisor and risk management mechanism which are internal problem of the bank and the existing supervisory and tax system can be considered as external challenges. Thus, due to these problems the bank has selected to start with the simplest and less risky type of IFB products- Murabaha- though there is request for the other types of products.
- This study has identified the challenges to deliver IFB products as lack of commitment of the bank, lack of Shariah advisor, lack of supportive supervisory directive and lack of capacity to deliver full range of IFB products. While the challenges to use IFB products are: lack of trust and confidence, lack of awareness of customer, inadequate marketing and promotion, double taxation, nature of IFB products, inaccessibility of IFB products, the IFB being delivered in a Window model.

### 5.3 Recommendation

This section presents recommendations of the study based on the results of analysis and conclusions which believed to enhance the delivery and use of IFB products in Ethiopian banking market.

- IFB is emerging business as an alternative banking system for those who are not using conventional banking for their banking need. It assists the idle fund to bring in to the banking system for better utilization by the economy. Within its short span of life it has proved that there is need for IFB products. In this time the bank has collected sum of money though the current challenge has limited the best utilization of the existing IFB product which has led to excess liquidity and not to extend the other types of IFB

products even though there is demand from the customer. If these challenges continue to persist IFB will not play its role as expected. Thus, all the stakeholders should work together to wipe out these challenges though NBE and banks have to take the leading role in the initiative.

- Proper study should have been done by the NBE as a major stakeholder before it launches IFB business in the country. What has been identified as challenges of IFB would not hamper its operation had the necessary platform to do the IFB business been identified and lay down initially by NBE including banks. Thus, NBE has to take the initiative to turn things out that stand against and became bottleneck for the implementation of IFB business. It has to start by amending its directive SBB/12/1996 which indirectly banned IFB product or allow having exceptions for IFB business operation and expanding the scope of the current IFB directive SBB/51/2011 to give guidance and detailed directions on the operation as it is critical in many aspect. In addition to this authority like Tax and ECX shall let their laws include exceptions for IFB business undertaking. So that the double taxation problem and problem related to selling of commodities purchased from ECX floor to the bank's export customer shall be resolved. It requires the participation and the understanding of all these and others who directly or indirectly affect or being affected by the IFB business activity to create conducive environment for IFB business to grow and succeed in the country. Furthermore, NBE shall consider the IFB business to be undertaken at least through branch model.
- The study showed that there is demand for IFB products so the bank has to be ready and committed in all aspect to deliver these products. To materialize this, the bank has to devise risk management mechanisms, acquire facilities which are necessary to deliver IFB products, hire/develop knowledgeable and experienced manpower.
- Banks and NBE shall work together with the country's Shariah council to develop workable and country level Shariah standard (Guideline) to smoothen the process of introduction and delivery of new IFB products and managing IFB business as well. Besides, it would help to bring consistency across the industry, and avoid the possibilities of breaching relevant Shariah dictates/provisions where the repercussion would be damaging as the issue is sensitive. In addition to this, to solve the problem of



obtaining well qualified (in Shariah and business) Shariah advisor, the Shariah council shall support banks endeavor in this respect.

- Bank as service provider need to have the required level of expertise about IFB and cascade to the user through different means to undertake the business. There is a need for sustainable and continuous training to build the capacity of the bank staff for successful implementation and use of IFB products/services. Thus, it has to provide its staff with the essential and standardize training and seminar by well qualified and experienced trainer to increase the capacity of its staff to develop and deliver IFB products/services. This has to be arranged on continuous and consistent base. It has to further arrange experiencing sharing and exposure visit and establish work relationship with international Islamic finance institution and foreign banks that have rich experience in running successful IFB business. In the meantime, bank should hire qualified and skilled manpower especially experienced in interest free banking. This will create for the existing staff good opportunity to acquire on Job training and experience too. In addition to this the bank has to benchmark the operation and IFB products and customize it to fit to our country banking system.
- As IFB products are new to the market, it is the responsibility of the bank to market its products. Thus, the bank has to promote the products/services aggressively by developing good marketing and promotion strategy that will promote the products to the market and create awareness to the general public. As the finding of this research showed that customers have low level of awareness about IFB products, so, awareness creation particularly towards the target market (the Muslim community) must be done consistently. The bank has to develop well planned and effective marketing and promotion strategy like reaching the target market through the religious leader, use praying days where significant number of the target population easily available to advertise the IFB products in addition to the mainstream media and customer session. The awareness creation has to center to clear the misconception about IFB and its product/services.
- Alongside awareness creation, bank has to build the trust and confidence of its customer by being transparent/disclose all its products, transaction and its IFB business activity to the public and confirm they are in line with Shariah. To support this action further the

bank immediately has Shariah advisors. Transparency is one of the principles of IFB that clear out doubt that customer has about the bank's transaction and business activity is really based on Shariah or not. According to Pasha (2014) perception of Muslims that is the trust and confidence about the existing practice of IFB is truly of Shariah compliant and not a copy of the conventional banking with a banner of Shariah compliant is very important issue for IFB existence and success.

- The Bank has to increase the accessibility of IFB products through increasing IFBW at customers' convenience and avail its products/services in most of and major branches with the necessary facility that will increase the marketability of IFB products/services.
- Generally, NBE and bank have to give IFB strategic focus as it has significant potential which will benefit the bank in particular and the country in general.

#### **5.4 Recommendation for further study**

The contribution of this study is vital as it has identified the major challenges for bank to deliver, and customers to use IFB products. However, the study is bounded by both area coverage and problem addressed. Therefore, future studies can be conducted with wider scope and the effects of these challenges on the success of IFB.

## References

- Al-Jarhi, M and Iqbal, M (2001), „Islamic banking answer to some frequently asked questions“, Islamic development bank: Islamic research and Training institutes:, Occasional paper no. 4
- Al-Sultan, W 1999, „Financial characteristics of Interest free banks and conventional bank“, Doctor of philosophy thesis, Department of accounting & finance, University of Wollongong
- Aris, N et al (2013), „Islamic banking products: Regulations, Issues and challenges“, The Journal of Applied business Research, Vol.29, No.4
- Bello A & Abubakar M (2014), „Challenges and Solutions to Islamic Banking System in a Pluralistic–Secular Country like Nigeria“, Mediterranean Journal of Social Sciences MCSER Publishing, Rome-Italy Vol. 5 No 6.
- Belouafi, A & Chachi, A (2014), „Islamic Finance in the United Kingdom: Factors Behind its Development and Growth“, Islamic Economic Studies , Vol. 22, No. 1, pp 37-78.
- Bhattacharjee, A 2012, Social Science research: Principles, methods, and practices, Jacobs foundation, Zurich, Switzerland.
- Carvalho, J. (1984). Archival application of mathematical sampling techniques. Records management quarterly, 18, 63
- Chong, B & Liu, M (2009), „Islamic banking: Interest –free or Interest based“, Pacific basin finance Journal Vol. 17, Issue 1, pp 125-144.
- Debebe, A. (2015), „Factors Affecting Customers to Use Interest Free Banking in Ethiopia“, An MBA Thesis submitted to Addis Ababa University, Department of Accounting
- Document of Commercial Bank of Ethiopia (December 2015)
- Hair, J. F. J., Anderson, R. E., Tatham, R. L., & Black, W.C (2006). *Multivariate data analysis* (5<sup>th</sup>ed.).New Jersey: Prentice-Hall
- Hassan, M & Lewis, M (2007), „Handbook of Islamic banking“, Edward Elgar publishing Ltd, UK

Ibrahim, A (2012), „An empirical analysis on the operational challenges of interest free banking window in Nigeria: a case study of keystone bank limited in Nasarawa state“, European scientific Journal, July edition Vol.8, No. 15.

Iqbal, M, Ahmad, A & Khan, T (1998) „Challenges Facing Islamic Banking“, Islamic Development Bank, and Islamic Research and Training Institute Occasional Paper No. 1.

Irfan,M, Majeed, Y & Zaman,K (2014), „The performance & efficiency of Islamic Banking in South Asian countries“, Economia Seria Management, Vol. 17 , Issue 2.

Jabr, H. (2003). „Islamic Banking in Palestine Challenges and Prospects“. An – Najah University J. Res. (H.Sc), 17(1).

Kahf M , Ahmed, A & Homud, S (1998), „Islamic banking and Development: an alternative banking concept“, Islamic Research and Training Institutes, Jeddah

Karbhari, Y, Naser, K & Shahin Z, (2004), „Problem and challenges facing the Islamic banking system in the West: The case of the UK“, Thunderbird International business review, Vol.46 (5)

Kettell, B (2011), „Introduction to Islamic banking and finance“, first edition, John Wiley and Sons Ltd., UK.

Kinyanjui, S (2013), „Challenges Facing the Development of Islamic Banking. Lessons from the Kenyan Experience“, European Journal of Business and Management, Vol.5, No.22

Krejcie, R & Morgan, D (1970), „Determining sample size for research activities“, Educational and psychological measurement, 30, 607-610.

Mohammed , A.U. (2013) , „Challenges facing the Acceptability of Islamic Banking In Nigeria“, International Journal of Economic Development Research and Investment, Vol.4, No. 3

Moin, M (2008), „Performance of Islamic Banking and Conventional Banking in Pakistan: A Comparative Study“ Master Degree project in Finance, University of Skovda, School of Technology and Society

Mounira, B (2008), „Managing risks and liquidity in an Interest free banking framework: The case of the Islamic banks“, International Journal of Business and management, vol.3, No.9

Mohammed, M (2012), “Islamic banking: Prospects, opportunities and challenges in Ethiopia“, An MBA Thesis submitted to Addis Ababa University, Department of Accounting and Finance.

Njamike, K. (2010), „Introduction of Islamic Banking in Zimbabwe: Problems and Challenges“, Journal of Sustainable Development in Africa, Vol. 12 No.8.

Olaoye, I, Dabiri, M & Kareem, R (2013), „Islamic banking in Nigeria: - Challenges and Prospects“, International Journal of management Sciences Vol. 1, No.1

Pasha, A (2014), „Role and Progress of Islamic Banking in India, Ethiopia and Rest of the World-An Analysis“, European Journal of Business and Management, Vol.6, No.17

Samad, A (2004), „Performance Of Interest-Free Islamic Banks Vis-À-Vis Interest-Based Conventional Banks Of Bahrain“ IIUM Journal of Economics and Management 12, no.2

Sefiani, Z (2014), „Policy Analysis on Ethiopia Interest free banking (IFB) Directive“ unpublished work prepared for Mercy Corps.

Saleh, A & Zeitun, R (2005), „The Development of Islamic Banking in Lebanon: Prospects and Future Challenges, Review of Islamic Economics, Vol.9, No. (2).

Sekaren, U (2003), „Research methods for businesses, John Wiley & Sons Inc, New York.

Teferi, M (2015), „Contribution of IFB to economic development and its prospect in Ethiopia“, An EMBA Thesis submitted to Addis Ababa University, Department of management

Ziauddin A, (1994), „Islamic banking: State of The Art“, Islamic Research and Training Institute, Jeddah, 1994, p.13

Standard and Poor’s rating services, „Islamic Finance outlook 2015“ McGraw Hill financial.

[www.ft.com](http://www.ft.com)>market>emergingmarkets, Islamic banking advances in Southeast Asia accessed at 27/03/2016@ 06:10pm

Ethiopian Central Statistics Authority official web site: [www.csa.gov.et](http://www.csa.gov.et) accessed at 12/02/2016

## Glossary

**Interest free banking:** means Islamic banking.

**Islamic banking:** is banking which provides banking services based on Islamic law (Shariah).

**Interest free banking window:** a business model in which conventional banks offer Islamic banking products and services from their existing network.

**Halal:** Shariah compliant

**Unrestricted Investment Deposits (Unrestricted Mudaraba):** is an earning deposit which mobilized with the knowledge that bank acts as the Mudarib (manager) and invests the fund without restriction and intervention of the capital provider in any Shariah compliant manner.

**Restricted Investment Deposit (Restricted Mudaraba):** is an earning deposit which is mobilized with the knowledge that bank acts as the Mudarib (manager) and invests the fund in restricted investment based on active intervention of the capital provider complemented with professional advice from the bank side.

**Wadiah (Safekeeping) Deposit:** is a peculiar non-earning type of IFB deposit that operates under the contract of Wadiah Yad Dhamanah (guaranteed custody).

**Demand Deposit (Amana Current Accounts):** are non-earning deposits that operate based on the principle of al-wadiah, whereby the depositors are guaranteed repayment or withdrawal of their funds on demand.

**Mudarabah (Silent Partnership):** is a financial transaction in which there are two partners in the contract. 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.

**Murabahah (Cost-Plus Sale Contract):** is a sale contract between Islamic bank and its client at a fixed profit called mark-up.

**Ijarah (Lease):** 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.

**Musharaka (Equity Partnership):** is a contract in which two or more persons contribute capital for the establishment of a particular business venture. 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.

**Salam (Forward Trade Contract):** 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.

**Istisna (contract of manufacture):**

It is a contract in which a party orders another to manufacture and provide a commodity, the description of which, delivery date, price and payment date are all set in the contract. It is used by Islamic banks, and consists of two separate Istisna contract.

**Shariah:** is the religious law of Islam

## **Annex**

### **Bank employee Deposit/Credit**

**Addis Ababa University**  
**College of Business and Economic**  
**Department of Management**  
**Executive Masters of Business Administration**

#### **Dear Respondents,**

I am conducting research on „challenges on the delivery and use of interest free banking with particular reference to commercial bank of Ethiopia“ as a partial fulfillment of EMBA study at the college of business and economics, Addis Ababa University. The main objective of this research is to investigate what are the challenges of interest free banking in relation to the delivery and use of its products. For the successful accomplishment of the study, your response will have a pivotal role by providing valuable input for the study. Thus, your genuine and honest response is very crucial for attaining the aim of the research and the researcher would like to thank you for your cooperation in advance.

#### **Attention**

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

**Thank you in advance for your cooperation**



## **Part one: Background Information**

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

1.1 **Educational qualification:** Diploma ☐ BA/BSC ☐ Masters Degree ☐ PHD ☐

1.2 **Current Job Position in the bank:** \_\_\_\_\_

1.3 **Banking Experience in number of years:**

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

1.4 **Exposure to Interest free banking:**

Up to 1 ☐ 1-2 year ☐ 2-3 year ☐

## **Part Two: Capacity, Demand and awareness**

This part is divided in to three sections, in each section there are statements which address issue about the bank’s capacity to deliver interest free banking products, level of demand and customer awareness about other ( products which the bank currently not providing) types of interest free banking products. Therefore, Please read each of the statements in each section and rate your level of agreement or disagreement with each statement by using a tick mark „√“ on one of the five alternatives.

## 1. Bank's capacity to provide interest free banking products

Items		Strongly disagree 1	Disagree 2	Neutral 3	Agree 4	Strongly Agree 5
1	The bank has knowledgeable manpower to provide interest free banking					
2	The bank has experienced manpower to provide interest free banking					
3	The bank has the necessary IT infrastructure to process, delivery and let use the customer the products and services of interest free banking					
4	The bank has the skill to develop interest free banking products that suites the current and future Ethiopian market					
5	The bank has the knowhow to promote interest free banking products					
6	The bank provides its interest free banking products at convenient branches and adequate windows with the customer expectation.					

## 2. Level of Demand for interest free banking products

Items		Strongly disagree 1	Disagree 2	Neutral 3	Agree 4	Strongly Agree 5
1	The bank is providing interest free					

	banking products that meet the current demand of its customer.					
2	There is no demand for interest free banking products other than the currently availed one.					
3	The bank has availed interest free banking products that customers really need.					
4	Customers request more frequently Murabaha financing product					
5	Customers request more frequently Musharaka financing product					
6	Customers request more frequently Istisna financing product					
7	Customers request more frequently Ijarah financing product					
8	Customers request more frequently Selam financing product					
9	Customers request more frequently Murabaha financing product					

### 3. Customer awareness level about Interest free banking products

Items		Strongly disagree 1	Disagree 2	Neutral 3	Agree 4	Strongly Agree 5
1	Customers have awareness about the major types of interest free banking products.					
2	The customers knows the Interest free banking products that currently provided by the bank.					

3	The customers Knows that Interest free banking products are offered to Muslim and non Muslim users.					
4	The customers knows about Quard					
5	The customers knows about Amanah					
6	The customers knows about Mudarabah					
7	The customers knows about Murabahah					
8	The customers knows about Musharaka					
9	The customers knows about Istisna					
10	The customers knows about Ijarah					
11	The customers knows about Salam					

### **Part three: Open ended question**

1. Please list down the type of products that frequently requested by customers other (currently not provided by the bank) than the already availed one.

---



---

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

---

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

---

4. What do you think are the reason(s) for the bank to limit its interest free banking products to the existing one?

---



---

5. If you have any opinion, comment regarding the challenges on the delivery and use of interest free banking products, please specify below.

**Thank you**

## አዲስ አበባ ዩኒቨርሲቲ

### ቢዝነስና ኢኮኖሚክስ ኮሌጅ

#### ከወለድ ነፃ የባንክ አገልግሎት ተጠቃሚ ደንቦች መጠይቅ

ይህ መጠይቅ የአዲስ አበባ ዩኒቨርሲቲ በቢዝነስ አመራር ማስተር ተማሪ የተዘጋጀ ሲሆን አላማው በኢትዮጵያ ንግድ ባንክ ስለሚሰጠው ከወለድ ነፃ የባንክ አገልግሎት መረጃ ለመሰብሰብ ነው። መረጃው የሚያገለግለው ርዕሱ 'በኢትዮጵያ ንግድ ባንክ ከወለድ ነፃ የባንክ አገልግሎቶችን በማቅረብ እና በመጠቀም ላይ ያሉ ተግዳሮቶች' ለሚለው ነው። የሚሰበሰበው መረጃ ለጥናቱ ብቻ የሚውል ነው። ስለዚህ የእናንተ መጠይቁን በትክክል በመሙላት ጥሩ ጥናት እንዲደረግ ይጠቅማል እና እባክዎን የሚከተሉትን ጥያቄዎችን በትክክል ይሙሉልን። ለትብብርዎት በቅድሚያ እናመሰግናለን።

#### ማሳሰቢያ

1. ስምዎትን መፃፍ አያስፈልግም
2. አማራጭ ላሉዋቸው መጠይቆች ከተሰጡት አማራጮች ይምረጡ

#### **መደብ አንድ: የግል መረጃ**

1.1 ሀይማኖት: \_\_\_\_\_

1.4 የኢትዮጵያ ንግድ ባንክ የመደበኛ የባንክ አገልግሎት የስንት አመት ደንበኛ ኖት?

ተጠቅሜ አላውቅም ☐ ከአንድ አመት በታች ☐ ከ1-3 አመት ☐ ከ3-5 አመት ☐ ከ5 አመት በላይ ☐

1.5 የኢትዮጵያ ንግድ ባንክ የስንት አመት ከወለድ ነፃ የባንክ አገልግሎቶች ደንበኛ ኖት?

ከአንድ አመት በታች ☐ ከ1-2 አመት ☐ ከ2-3 አመት ☐

#### **መደብ ሁለት: የተጠቃሚ ግንዛቤ እና ፍላጎት እንዲሁም የባንኩ አቅምን ይመለከታል**

ይህ መደብ በሦስት ክፍል የተከፈለ ሲሆን በእያንዳንዱ ክፍል ውስጥ ከወለድ ነፃ የባንክ አገልግሎት ተጠቃሚውን ግንዛቤ እና ፍላጎት እንዲሁም የባንኩ አቅምን የሚመለከቱ ዐ/ነገሮችን ያካተተ ነው። ስለዚህ እንደስምምነታችሁ እና አለመስማማታችሁን መጠን ከታች በቀረቡት አማራጭ መሰረት ይህን ምልክት/ ያድርጉ።

1. ስለ ወለድ ነፃ የባንክ አገልግሎት የተጠቃሚ ግንዛቤ ለመለካት

Items		በጣም አልስማማም 1	አልስማማም 2	ገለልተኛ 3	እስማማለሁ 4	በጣም እስማማለሁ 5
1	ስለ ከወለድ ነፃ የባንክ አገልግሎቶች በቂ እውቀት አለኝ።					
2	አሁን በባንኩ እየተሰጡ ያሉትን ከወለድ ነፃ የባንክ አገልግሎቶች አውቃለሁ።					
3	ከወለድ ነፃ የባንክ አገልግሎቶች የተለያዩ ሀይማኖት ተከታዮች መጠቀም እንደሚችሉ አውቃለሁ።					
4	ቀርድ የተሰኘውን ከወለድ ነፃ የባንክ አገልግሎት አውቃለሁ።					
5	አማና የተሰኘውን ከወለድ ነፃ የባንክ አገልግሎት አውቃለሁ።					
6	ሙዳረባ የተሰኘውን ከወለድ ነፃ የባንክ አገልግሎት አውቃለሁ።					
7	ሙራባሃ የተሰኘውን ከወለድ ነፃ የባንክ አገልግሎት አውቃለሁ።					
8	ሙሻረካ የተሰኘውን ከወለድ ነፃ የባንክ አገልግሎት አውቃለሁ።					
9	ኢስቲስና የተሰኘውን ከወለድ ነፃ የባንክ አገልግሎት አውቃለሁ።					
10	ኢጃራ የተሰኘውን ከወለድ ነፃ የባንክ አገልግሎት አውቃለሁ።					
11	ሰላም የተሰኘውን ከወለድ ነፃ የባንክ አገልግሎት አውቃለሁ።					

2. ስለ ከወለድ ነፃ የባንክ አገልግሎት የተጠቃሚዎች ፍላጎት ለመለካት

Items		በጣም አልስማማም 1	አልስማማም	ገለልተኛ	እስማማለሁ	በጣም እስማማለሁ 5

		2	3	4	
1	በአሁን ወቅት ባንኩ ለተጠቃሚዎቼ እያቀረበ ያለው ከወለድ ነፃ የባንክ አገልግሎቶች አይነት በተጠቃሚውን ፍላጎት ላይ የተንተራሰ ነው።				
2	ባንኩ ለተጠቃሚዎቹ እያቀረበ ያለው ከወለድ ነፃ የባንክ አገልግሎት አይነት ለፍላጎቱ በቂ ነው።				
3	ባንኩ እያቀረበ ካለው ከወለድ ነፃ የባንክ አገልግሎቶች በተጨማሪ ፍላጎት የለም ።				

### 3. ከወለድ ነፃ የባንክ አገልግሎት አሰጣጥ ጋር በተገናኘ የባንኩ አቅም ለመለካት

Items		በጣም አልስማማም 1	አልስማማም 2	ገለልተኛ 3	እስማማለሁ 4	በጣም እስማማለሁ 5
1	ባንኩ ከወለድ ነፃ የባንክ አገልግሎቶቹን የሚያቀርበው በቂ እውቀት ባለው የሰው ሀይል ነው።					
2	ባንኩ ከወለድ ነፃ የባንክ አገልግሎቶቹን ለማቅረብ የሚያስችል በቂ ልምድ ያለው የሰው ሀይል አለው።					
3	ባንኩ ከወለድ ነፃ የባንክ አገልግሎቶችን ለማቅረብ የሚያስችለው አስፈላጊ መሰረተ ልማቶች አሉት።					
4	ባንኩ የተጠቃሚውን ፍላጎት የሚመጥን ከወለድ ነፃ የባንክ አገልግሎቶችን ለመፍጠር የሚያስችለው ችሎታ አለው።					
5	ባንኩ ከወለድ ነፃ የባንክ አገልግሎቶቹን ለደንበኞች በተመቹ ቅርንጫፎች እና በሚጠብቁት የአገልግሎት ደረጃ ያቀርባል/በበቂ ቅርንጫፎች አገልግሎቱን ያቀርባል።					

## መደብ ሦስት

1. ከወለድ ነፃ የባንክ አገልግሎት አይነት ለመጠቀም ፈልገው ያላገኙት የአገልግሎት አይነት ካለ ቢጠቅሱልን

-

---

---

2. ከወለድ ነፃ የባንክ አገልግሎቶች እንዲያጠቀሙ ችግር ወይም ተገዳሮት የሆኑበት ጉዳዮች ካለ ቢዘረዝሩልን

---

---

3. በርስዎ አመለካከት ባንኩ ውስን ከወለድ ነፃ የባንክ አገልግሎቶች ብቻ እንዲያቀርብ ያደረጉት ምክንያቶች ምን ይመስሉታል

---

---

4. ከወለድ ነፃ የባንክ አገልግሎቶች አቀራረብ እና አጠቃቀም ላይ ያሉትን ተጨማሪ ሀሳብ ወይም አስተያየት ካሎት ቢገልፁልን

---

---

አመሰግናለሁ



### **Interview Question for bank management**

1. What type of interest free banking products does the banking currently made available to its customers?
2. What are the factors which made the bank to limit its current product type only to the existing ones?
3. Does the bank face any challenges to deliver interest free banking products?
4. Do you think the bank has the capacity to provide the other interest free banking products to its customers- competent employee, IT, the necessary infrastructure?
5. What do you think of the level of awareness of your customers about the other IFB products?
6. Does customer request/demand for other IFB product that the bank currently not providing?
7. What do you think the challenges that interest free banking products user face on utilization IFB products?
8. Do you think the bank is providing products that meet the demand and expectation of customers?