

Factors Affecting Islamic Banking Financial Services in Ethiopian Banking Industry; in the Case of Commercial Bank of Ethiopia

Edilawit Gebregiorgies*

Department of Accounting and Finance, Debre Markos University, Debre Markos, Ethiopia

Abstract

This study is undertaken to investigate the factors affecting Islamic banks' financial services in Ethiopian banking industry with specific reference to commercial bank of Ethiopia branches found in Harar town. To achieve the aim of the study the primary data was collected through standard questionnaires. For measurement purpose, the Likert scale method was used to range of responses. The sample size was made up of 218 respondents. In which 18 interest free window employees and 200 customers are included. Purposive sampling technique was applied in sample selection. Analysis was done using inferential statistics using SPSS software. To determine existing relationship between the variables of study the researcher used correlation and regression analysis. The study result reveal that, all independent variables that are relative advantage, complexity, awareness, compatibility and perceived risk have small positive relationship and statistically significant correlation with dependent variable that is Islamic banking financial service. To conclude, the independent variables have serious effect on the Islamic banking service of CBE branches in Harar town. The bank should prepare different awareness creation programs and advertisement packages to create good awareness regarding Islamic banks operation and their services through focusing and continuing the Awareness creation programs using different occasions.

Keywords: Commercial bank of Ethiopia • Interest free • Awareness • Complexity • Relative advantage and compatibility

Introduction

The economic development of any country depends on the existence of well organized financial system. Financial institutions are one important components of financial system of a given country. As Ethiopian financial system is bank dominated, banks are a part of those institutions which accept deposit from economic agents and then lend these funds to make direct loans or invest in security like stocks and bonds. Banks operates by charging interest as well as operates without charging interests. Interest is fee paid for usage of others money. To the borrowers it is the cost of renting money to the lender it is income for lending the money. Islamic banks operate without charging interests. Islamic banks are derived from Islamic world, it is fundamental concept it operate primitive professional and ethical investing while elimination of interest in all its forms is an important future of the Islamic financial system [1-3].

One of the most emerging trends in the global economies is the idea of Interest free banking and Finance that emerged in the global landscape as an alternative banking system which is in line with values and ethos of Islam, and governed by the principles of Sharia

Law that requires not charge interest and avoid any unethical practices in achieving its goals and objectives. This form of interest free banking has developed over a long period of time in Egypt in 1963 with the introduction of new products in the industry. The role and functions of Islamic banking within the banking system in a modern economy are very important, and in fact, it is at the heart of every robust economy. Hence, Islamic banking is growing at an average rate of 15 percent a year in size and number, which makes it the fastest growing sector in the financial markets of the contemporary world [4-7].

Despite the growth of Islamic banking worldwide, as the others African countries Ethiopian banking industry was continued to conduct most of their banking transactions using traditional banking system because of lack of supportive regulatory and policy regimes that facilitate the establishment of Islamic financial institutions is the most important worth of mentioning. Since, Muslims believe that banking with the conventional banks is against their religious faith; large numbers of potential Muslim customers are not banking with the existing conventional banks available in the country. To satisfy the community that have problem with the current banking system and to

*Address for Correspondence: Edilawit Gebregiorgies, Department of Accounting and Finance, Debre Markos University, Debre Markos, Ethiopia, Tel: 2510961091325; E-mail: edilegnabehone@gmail.com

Copyright: © 2022 Gebregiorgies E. This is an open-access article distributed under the terms of the creative commons attribution license which permits unrestricted use, distribution and reproduction in any medium, provided the original author and source are credited.

Received: 11 June, 2022, Manuscript No. JAMK-22-66427; **Editor assigned:** 14 June, 2022, PreQC No. JAMK-22-66427 (PQ); **Reviewed:** 29 June, 2022, QC No. JAMK-22-66427; **Revised:** 11 August, 2022, Manuscript No. JAMK-22-66427 (R); **Published:** 19 August, 2022, DOI: 10.37421/2168-9601.2022.11.386

provide alternative banking system the National Bank of Ethiopia (NBE) was expected to approve a directive that paves the way for the establishment of what was called as the first Islamic bank in Ethiopia. A circulated draft form of the NBE's directive has allowed Ethiopian nationals to establish a bank exclusively engaged in interest free banking," however, that hope was short lived one as the finally issued draft does not allow the establishment of full fledged Islamic financial institution.

According to national bank of Ethiopia interest free banking service mean a system of banking or financial activity that is compliant with Sharia principles and guided by Islamic economics which prohibits the collection and or payment of interest as well as engaging in activities forbidden by Sharia. Interest free banking provides profit sharing investment accounts to the depositors. As national bank of Ethiopia allows for banks to provide interest free banking services with directive No-72 in branch level or as fully fledged operation, Islamic banks like Hijra bank, Zamzam Bank, Zad banks starts their formation to play their own role for development of saving and investment of the country [8].

However, the directive has only opened the door for "existing commercial banks" to create an interest-free banking window alongside of their operations. This come in to force in October 2011, but interest free banking in Ethiopia started only in September 2013, when the oromia international bank S.C launched the service. The commercial bank of Ethiopia joined the market at the end of October, followed by United bank S.C, which began providing the service on May 1, 2014. The introduction of interest free banking in Ethiopian banking industry is important for being a world class bank, and in addition, to provide options for the customers [9-12].

Moreover, interest free banking is a new system in Ethiopia which needs a lot of effort and resources to be easily adopted by customers. As the document of some commercial banks in Ethiopia indicated there are financial products and services outdated without even compensated the costs of its adoption. Hence, in order to help banks, improve interest free financial product and services adoption by their customers, it is necessary to identify factors that influence product and service they provide. Accordingly, this study aims to identify determinants factors affecting Islamic banks' financial products in Ethiopia banking industry.

Statement of the problem

The expansion of the Islamic finance industry to all corners of the world is continuously increasing as an alternative financial system for those who are not accessed conventional finance. The growth and wealth of global Islamic finance are blooming year to year. The global Islamic finance wealth is dominantly owned by Gulf Cooperation Council (GCC), South East Asia, Middle East and South Asia countries. Islamic Finance Industry in Africa is still at the infant level, and its share from global Islamic finance is about 1.6%.

Financial institutions plays great role within a given countries economy by intermediating resource from lenders to borrowers. The low level of investment in developing countries largely attributed to the low level of saving, low level of job opportunity and low level of economic growth. It is unquestionable that investment plays a leading role for the growth of a countries economy but this requires the accumulation of capital and appropriate allocation of accumulated

capital. Islamic bank can play their own role in capital accumulations and loan disbursement of the country [13-15].

The empirical evidence shows that Interest free banking have rapidly spreading and developing across the world. Some factors appear to be correlated with the diffusion of IFB, namely the principles of risk sharing that underlie financing, the growth of oil rich economies, the presence of Muslims in the population, an enabling legal framework, and economic integration with Middle Eastern countries or proximity to Islamic financial centers. Wherever there is a sizable Muslim community and is not restricted to Muslim countries, the probability for Islamic banking to spread in a given country rises with the share of the Muslim population. According to Ibrahim, trading with the Middle East and economic stability are also conducive to the diffusion of Islamic banking.

Almost half of Ethiopian banking commercial industry out of eighteen banks has commenced Interest free banking service within less than three years while some others banks are also showed initiation to commence it. The rapid diffusion of interest free banking adoption by banking organization reflects their understanding of the importance and untapped demand it is as an alternative financing intermediary in stiff banking competition. In return, banking sectors investigation of factors influencing customers' behavioral intention to adopt interest free banking product and service, identifying resistance to adoption for product modification and frequently collecting feedback can help banks to mobilize significant amount of deposit thereby divert to financing that can create active economic circulation. Besides, interest free banking deposit market share is very low compared to conventional banks deposit and customer base; banks are increasingly making an effort to attract customers by through awareness campaign to attract potential customers [16].

At international level researchers have identified and investigated several factors considered as relevant in influencing customers as well as attracting them towards the adoption of the products and services. These studies have revealed that though there are some determinant factors common to many countries, there are also factors which are unique to each country due to social, cultural, economic, technological, political, religion and other factors. Furthermore, the study environment of the international researches were on Moslem dominated and or Arab countries; therefore, it could be difficult to implement policy recommendations of the respective researches directly in to the Ethiopian context.

Some limited studies were conducted on challenges and opportunities of interest free banking services in different parts of the world and in Ethiopia. For instance, Akmel Hailu's studied about "challenges and prospects of Islamic banking for resource mobilization in Ethiopian commercial banks. "The study focuses on challenges and opportunities of IFB only on resource mobilization other challenges and opportunities are not well addressed. Tsion sisay conducted research on challenges and opportunities of interest free banking in case of commercial banks operating in Addis Ababa. The result of this study stated that lack of awareness by customers and difficulty to segregate fund for effective implementation of IFB service. The researcher concludes that the opportunities of interest free banking are more significant than the challenges [17-20].

On the other hand Yewubedar Getachew also conducted research on challenges and opportunities of interest free banking in case of

commercial bank of Ethiopia northern district. The research concludes that lack of sharia advisors boards, lack of awareness of customers regarding interest free banking, lack of confidence by customers, unavailability of the service in all branches are challenges of interest free banking operation. In addition Robel Demissie conducted a research on factors affecting implementation of interest free banking service in Ethiopia: The mediation role of customer involvement. Even though the above researches are conducted in Ethiopia in different corners of the country, as per the researcher knowledge no research is conducted to investigate the determinant factors affecting Islamic banking financial services in Harar town particularly. So that, this research is designed to fill the above research gaps by assessing the determinant factors affecting Islamic banking financial services in Ethiopia with special focus on commercial bank of Ethiopia branches in Harar town based on the following research questions.

- Does relative advantage affect Islamic banking service?
- Does complexity has an effect on Islamic banking service?
- Does awareness has an effect on Islamic banking service?
- Does compatibility relates with Islamic banking service?
- Does perceived risk has effect on Islamic banking service?

Objectives of the study

General objective: The general objective this study is to investigate determinant factors affecting the Islamic banking financial services in Ethiopia in case of commercial bank of Ethiopia, Harar branches.

Specific objectives

- To determine how relative advantage affect Islamic banking service.
- To determine the effect of complexity on Islamic banking service.
- To determine the effect of awareness on Islamic banking service.
- To examine how compatibility relates with Islamic banking service.
- To determine the effect perceived risk has on Islamic banking service.

Research hypothesis

H₀₁: Perceived relative advantage has significant influence on using interest-free financial services in Ethiopian banking industry.

H₀₂: Complexity has significant influence on using interest free financial services in Ethiopian banking industry.

H₀₃: Customers' awareness has significant influence on using interest free financial services in Ethiopian banking industry.

H₀₄: Compatibility has significant influence on using interest free financial services in Ethiopian banking industry.

H₀₅: Perceived risk has significant influence on using interest free financial services in Ethiopian banking industry.

Scope of the study

This study is mainly confined on investigation of determinant factors affecting Islamic banking services in Ethiopia banking industry

particularly on commercial bank of Ethiopia branches found in Harar town in 2013 E.C.

Literature Review

Theoretical literature

Conventional and islamic banks development in Ethiopia: Modern banking was introduced in Ethiopia 1905. At the time, an agreement was reached in between Emperor Minelik II and a representative of the British owned National Bank of Egypt to open a bank which leads to Bank of Abyssinia launched in Feb.16, 1906 by the Emperor. In Ethiopia, regards to interest free bank; the government is cautiously promoting the establishment of a home-grown interest free banking industry. The Ethiopian government takes one important measure in 2008 G.C, with interest free banking proclamation No. 592-2008 at sub article 22(2) by allowing interest free banking business by window level. But the Muslim community not satisfies with the government decision and continues questions regarding Islamic banks establishment. To answer fully the Muslim communities' questions, Ethiopian government takes measure by allowing full fledged Islamic bank establishment with directive on interest free banking No.72-2019 G.C. After governments decision regarding the establishment of Islamic banks, different banks are starts their establishment processes. In another way the conventional banks in Ethiopia takes this government decision as treat and started to open interest free banks in branch level to maintain their customers and to get addition customers. The above theoretical literatures and banking history shows that Ethiopia as country uses both interest charged and interest free system co-existed like Indonesia, Malaysia, Pakistan and United Arab Emirates [21-23].

Concepts of interest free banking: Interest free (Islamic) banking refers to a system of banking or banking activity that is consistent with the principles of the Shari'ah (Islamic rulings) and its practical application through the development of Islamic economics. The principles which emphasize moral and ethical values in all dealings have wide universal appeal. Shari'ah prohibits the payment or acceptance of interest charges (riba) for the lending and accepting of money, as well as carrying out trade and other activities that provide goods or services considered contrary to its principles.

The Organization of Islamic Conference (OIC) defined an Islamic banking as "a financial Institution whose statutes, rules and procedures expressly state its commitment to the Principles of Islamic Shariah and to the banning of the receipt and payment of interest on any of its operations".

According to this statement it is clear that interest is fully prohibited in Islamic law due to its bad effects on human being and more badly effects on overall society and economy. In an interest based economy a trend arises that rich people create the methods to increase their wealth through effecting the middle and lower classes. In interest based economy the middle class cannot contribute positively in economic system then gradually the economy travel toward financial crises such as credit crunch [24].

An Islamic bank is an intermediary and trustee of other people's money with the difference that it shares profit and loss with its depositors. In practice the most Islamic banks have an organizational

set-up very matched and similar to their conventional counterpart banks. "Islamic banking is phenomenally profitable because, although it's underlying funding mechanism is the same as conventional banking, its default experience is better, and its charges higher and less transparent".

It is resulted from above statements that Islamic banking is not totally different from conventional banking. They are doing same practice such as saving deposits and consumer finances but there are some fundamental differences of its practice and objectives. Islamic banking is interest free and its main objectives are the equal distribution of wealth, decreasing the poverty and increasing the investment opportunities. It is very beneficiary for Muslim population who want to solve all their financial matter according to their religion. Because a number of Islamic and some high street commercial banks from all over the world offer products and services that are according to Sha'riah compliant. "Although the western media frequently suggest that Islamic banking in its present form is a recent phenomenon, in fact, the basic practices and principles date back to the early part of the seventh century" [25].

The term "interest free/Islamic banking" has no single definition. Many scholars" gives various meaning to this term Islamic banking. It refers to a system of banking or banking activity that is consistent with the principles of the Shari'ah (Islamic rulings) and its practical application through the development of Islamic economics. The principles which emphasize moral and ethical values in all dealings have wide universal appeal. Shari'ah prohibits the payment or acceptance of interest charges for the lending and accepting of money, as well as carrying out trade and other activities that provide goods or services considered contrary to its principles. While these principles were used as the basis for a flourishing economy in earlier times, it is only in the late 20th century that a number of Islamic banks were formed to provide an alternative basis to Muslims although Islamic banking is not restricted to Muslims [26].

Evolution of islamic banking: The origin of Islamic banking as a major player in the financial domain was in the early 1970's. But the rules and regulations governing Islamic banking system has been present in the world for many centuries. During the middle ages, Islamic finance was popular and was widely accepted and practiced. It helped in furthering the trade and business in the Muslim world. The Islamic merchants began to play a very important role in the European region. Islamic finance has become a global system spreading as far as Asia, the Middle East, and the Western world. Islamic banking is not limited only to the Muslim nations in the Middleeast but also exists in the developed economies such as USA, Europe, and the Far East. Today, more than four hundred and fifty (450) Islamic banks are operating from China to USA, having assets in excess of one trillion US dollars.

The principles of interest free banking

The principles of Interest free banking are based on Islamic law, known as sha'riah, which mean:

Interest (riba): Interest cannot be paid or received on transactions in any case where money is exchange for money, because money by itself does not have any value unless employed in business according to Islam.

Prohibition of riba (interest): Many Muslim scholars and some western thoughts believe and still considering that just interest free banking is as an Islamic banking. Actually interest is fully prohibited in Islam that is proved in Qur'an and sunnah. "the interest that you give in order to increase the wealth of the people, does not increase in the sight of God; and the zakat that you pay in order to win God's approval, its payers do indeed increase their wealth.

It is concluded from above statements that in Islam there is no room for interest. Interest is totally prohibited in Islam. In interest based economy the depositors want to get more interest and want to increase their wealth through interest. They are not taken part in investment activity it leads to collapse and credit crunch. On other hand the banks charge high rate of interest on loan, it creates the difficulties for poor people of the society and leads to maximize the wealth of industrialists and giants [27].

Gharar and Maysir: Transactions must avoid uncertainty (Gharar), speculation (Maysir) or anything that could lead to the unjust enrichment or unfair exploitation of one of the parties to a contract. In case of speculation the big investors and industrialists turn the economic financial system toward their own and personal benefits.

Unethical businesses: Transaction cannot be made that involve prohibited products or activities, such as alcohol, illicit drugs and tobacco because Islam wants to develop an ethical and friendly environment in the society.

The fundamental of interest free banking and finance: Islamic commercial law is actually based on four basic principles. The fundamental of first Islamic business principle is profit and loss sharing and the second is based on fixed service

Fees and charges and third is based on free of cost and no charges. The other principles are changing with the situation of the business and its operation.

Musharakah (Partnership Finance): Is a contract in which the bank and the industrialist contribute jointly to the capital of a company or project to make a profit. Profit and losses are shared between the parties on agreed term and condition of the contract.

Mudarabah (Trust Financing): Is a contract, in this contract it is the responsibility of the bank provides all the capital, the partner contributes commercial efforts, professional skills and experiences. Finally, the bank receives a predetermined proportion of the profits. In the case of a loss, the bank bears all the financial loss whilst the manufacturer goes unrewarded. It is concluded that this system encourage the individual to participate in financial activity and prove himself as an active part of society.

The third principles and the free charges among the principles: Murabaha (Cost-plus financing) is a contract in which the bank informs the industrialist about the acquisition cost of a good and negotiates with him the profit margin. It is one of the most popular modes used in Islamic banking system in different countries to promote interest free transactions.

Bai-mua'jal: (deferred payment sale) is a deferred payment sale contract which is traded without additional costs.

Ijara (Leasing): The Ijara is a rent contract by which the owner of the good rents it to another party. After that the latter can purchase it

and rent is reduced until the good become the possession of the client (Bellalah and Ellouz, 2004). Nowadays the Home Finance and Islamic mortgage are based on the concept of Ijara and it is very successful tool in Islamic financial system.

The three legal maxims of IFB

General permissibility: Everything is allowed unless specifically prohibited.

PLS (Profit and loss sharing): The one who takes the risk has the right to share in the profit.

Asset backed financing: If you want the asset financing then you have to show the asset.

Islamic/IFB mode of operations

Dedicated window model: Units within a conventional bank that exclusively offer IFB services' (NBE's Directive No.SBB 51/2011);

Refers to conventional banks that offer Islamic banking products and services using their existing infrastructure, including staff and branches.

Usually assurance is given for the segregation of client's funds with any interest based funds. E.g. ABSA Islamic bank south Africa, Citibank, HSBC, Lloyds of London:

- Dedicated branch model.
- Subsidiary model.
- Fully fledged Islamic bank model.

Operational challenges faced by interest free banking

Interest free banking is in infant stage in Ethiopia economy and some of the potential operational challenges should be taken up to make Islamic banking more productive in every segment of the economy and society. There is need to make a clear and transparent system of general Islamic banking which concerned to all sectors of society and economy in order to address the challenges and threats of the future needs of the financial sector. Islamic banking has been facing so many challenges since its origin. Islamic banking has been in transition and development phase in different countries for the last two decades. Islamic banking industries have always suffered with the issue of different opinions of Islamic scholars, suppose a product or practice may be accepted to one scholar, could be considered un-Islamic by another scholar. In Islamic banking system there is a serious shortage of scholars and qualified managers. Unfortunately the managers are not well trained in the use of Islamic financial practices.

Legal and regulatory challenges: It is fact that Islamic banking is not well regulated at the moment because they have not a strong branch network. And as same, what's most challenging about working in this area is that interest free banking is not progressing at the same pace as market demand. This is due to a lack of knowledge around regulations. Banks are unclear how to solve legal disputes that arise from interest free finance, and there is a still a gap in knowledge about how to design appropriate products. It is under working to build the capacity of staff to design financial products and how to evaluate the market and, working with the Ethiopian

government to establish an interest free finance advisory board that will assist the industry to navigate regulations.

Currently Islamic banking is facing the challenge of the new mode of conventional banking in opening of Islamic banking window. It will improve the services of Islamic banking but there is a need that Islamic scholars work hard to maintain the priority of Islamic Sha'riah Islamic banking is still highly promising as compared with conventional banking, and this is an immense factor contributing to the range of challenges IFB are currently facing; Due to the novelty of Islamic banking systems, their legal and regulatory frameworks are still quite complex and un-standardized.

Cash requirements/profit sharing challenges: Though the notion of Islamic banking in Ethiopia had resonated within the 2011's and has ramified to some part of the country in Ethiopia, its practice is still very new to their entire public and as such, individuals are risk averse in investing in such a venture. This has also been fueled partly by the national bank of Ethiopia. For instance, NBE require initial capital or cash requirement for license of banks is birr 500 million. Hence, one would see hardly business men/money lender putting such money on uncertainties just in name of Quaran' and Hadith of the Prophet. The profit/loss formula is only known to the pro-prietors and managers of Islamic banks which may generate corrupt practices by the some unprincipled personnel.

Misunderstanding and lack of standardization of IFB concept: Islamic financial institutions are compliance to Shariah law; it is not only applicable for Muslims. Under the study of Gerrard and Cunningham there are only few numbers of Muslims aware to the Islamic banking operation while there is almost none of non-Muslims have a clear concept for the Islamic finance culture. It proves that the customer awareness on Islamic finance sector is unfavorable, the education provided to customers regarding to the Islamic banking products are still insufficient.

According to the research done by Doraisamy, Shanmugam and Raman, the amount of residents in Sungai Petani who are familiar with Islamic banking operation are still low and the promotion about Islamic banking still unoptimistic. Some peoples may not differentiate the operation concept between conventional and Islamic financial institutions and they deemed that Islamic banking is merely a change in name without any others special features. They argue that the "profit rate" used under Islamic banks is just a substitution for "interest rate" under conventional banks.

Usually, most of the conventional banks offered the Islamic product based on different terms for example Wadiah or saving account. Most of the window or subsidiaries will use the familiar terms for market the products. One of the major reasons that causing the concept of Islamic financial system become ambiguous is because of the inconsistent point of view among different scholars. Based on research of Venardos, there are four common methodologies applied under Islamic financial institutions, which are: ijihad (interpretation by using existing sources), ikhtiyar (choice), darura (necessity) and hila (legal artifice). The application of different methodology will lead to the inconsistent of fiqh rulings. Due to the ambiguous concept for Islamic financial institutions, there are insufficient experienced professional in Islamic finance sector which retard the development of Islamic financial institutions. Research paper of Iqbal, Ahmad and Khan,

stated that there is an extreme insufficient of scholars available, who obtain working experience of both Islamic fiqh and modern economics and finance. In addition, many existing employees under Islamic banking are not been trained well in the use of Islamic financing modes. This leads the development problem of Islamic financial institutions occur.

Lack of supportive institutional and market links: Islamic banking is at an early stage of learning and experience, lacking the flexibility to choose arrangements which best suits their need in reacting to structural shifts in the economic setting as well as changes in consumer preferences. For example, Islamic banks, without having an interest free money and capital market, will not have adequate instruments to meet the pre-condition for liquidity management and effective maturity transformation.

So, adequate financial mechanism still has to be developed, without which financial intermediation, especially the risk and maturity transformation, will not be performed properly. Moreover, however well integrated it may be, any system cannot thrive exclusively on its built in elements. It has to depend on a number of link institutions and Islamic banking is not an exception to this rule.

Empirical literatures

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

Mohammed 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.

On the other hand Teferi’s study about the “Contribution of IFB to economic development and its prospect in Ethiopia”. He assessed the contribution of the inclusion of the Muslim population in the banking (financial system) to the economic development and GDP growth.

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

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

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

Akmel Hailu’s studied about “challenges and prospects of Islamic banking for resource mobilization in Ethiopian commercial banks. “The study focuses on challenges and opportunities of IFB only on resource mobilization other challenges and opportunities are not well addressed. On the other hand a research by Debebe Alemu who studied the factors affecting customers’ use of IFB in Ethiopia and found out that 100% of IFB account holders were all Muslims. Evidently, the failure of banks to meritoriously serve the Ethiopian Muslim population hinders the development of the Muslim inhabited areas in particular and the economy of the nation as a whole. This study is about impact assessment on the attitude towards IFB usage which does not address the current problem at hand.

Mohammed’s study which is about “Challenges on Interest Free Banking Services” The study discuss the challenge faced by service providers and users of IFB products and scope of service provided by Ethiopian banking through IFB including whether there is unmet demand of users, awareness of customers and capacity of bank. The study doesn’t addressed the opportunities of interest free banking as a new business strategy in Ethiopia.

Tsion sisay conducted research on challenges and opportunities of interest free banking in case of commercial banks operating in Addis Ababa. The result of this study stated that lack of awareness by customers and difficulty to segregate fund for effective implementation of IFB service. The researcher concludes that the opportunities of interest free banking are more significant than the challenges. On the other hand Yewubedar Getachew also conducted research on challenges and opportunities of interest free banking in case of commercial bank of Ethiopia northern district. The research concludes that lack of shariah advisors boards, lack of awareness of customers regarding interest free banking, lack of confidence by

customers, unavailability of the service in all branches are challenges of interest free banking operation.

In addition Robel Demissie conducted a research on factors affecting implementation of interest free banking service in Ethiopia: the mediation role of customer involvement. The result of this research showed that awareness, comparability, complexity, observability, perceived risk; religious beliefs and customers involvement were significant on the implementation of interest free banking service.

Conceptual framework of the study

The conceptual framework depicts the relationship between the dependent and independent variables. For this study purpose, the conceptual frame work of the study is summarized as follow (Figure 1):

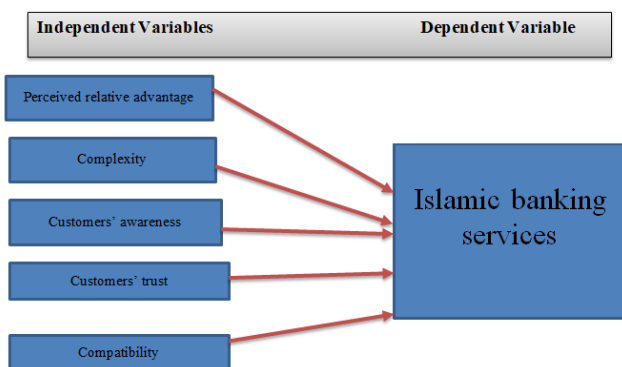


Figure 1. The conceptual frame work of the study is summarized as follow.

Source: Author, 2020

Research methods

Research design: Inferential analysis was used to achieve the research objectives. The objective of this study is to investigate the factors that affect Islamic banking financial services in Ethiopian banking industry in the case of commercial bank of Ethiopia found in Harar town.

Data type, source and methods of data collection: In this study the researcher used primary data and it is obtained from primary sources of data that are interest free window employees of the bank and their customers. The necessary data are collected through questionnaire. For measurement purpose, the Likert scale method was used to range of responses: strongly disagree, disagree, Neutral,

Agree, and strongly agree, with a numeric value of 1-5, respectively. Likert-scale is used to ask many people the same questions and examining their answers research questions.

Target population, sample size and sampling techniques: The target population consists of Interest free window employees and customers. There are 5 commercial bank of Ethiopia branches in Harar town. The minimum of 3 Interest free window employees from each branches of the bank totally 18 respondents were considered. The number of customers consisted by these branches is very large. According to Hair, a sample size between 200 and 400 is usually acceptable as critical sample size for this kind of studies. Therefore, 40 customers from each CBE branches that is 200 customers were considered as sample size by using purposive sampling techniques.

List of CBE branches in Harar town

- Commercial bank of Ethiopia (Aboker branch)
- Commercial Bank of Ethiopia (Gelmeshira Branch)
- Commercial Bank of Ethiopia (Jenila Branch)
- Commercial Bank of Ethiopia (Shenkor Branch)
- Commercial Bank of Harar Main Branch

Method of data analysis: Inferential analysis was used to achieve the research objectives. Pearson correlation analysis also used to determine the relationship of variables before regression taken and then linear regression analysis would be used to determine the potential connection between independent variables of this study and the dependent variable of study. Regression analysis was used to identify impacts of independent variables.

Validity and reliability: Reliability defined as the consistency, dependability and replicable of the measuring instrument over time, and with the same respondents. To check the reliability of the instruments uses in the study, Cronbach alpha is computed. Cronbach alpha is computed for each five independent variables. According to Hair et al. an acceptable reliability coefficient is greater than 0.7 and if it is smaller than 0.3, then it implies that there is low reliability. As the current study uses multiple items in all variables, internal consistency analysis was carried out through Cronbach's alpha reliability tests. The results of the reliability analysis, one can conclude that the items are consistent. To find the reliability of the empirical data, consistency analysis has been done using SPSS. Consistency analysis is used to find the internal consistency of the observed data, and ranges from 0 to 1. The Cronbach alpha result summarized as follow (Table 1):

Instruments reliability

Constructs	Cronbach's alpha
Relative Advantage (REA)	0.843
Complexity (CPX)	0.806
Compatibility (CPT)	0.822
Awareness (AWS)	0.826
Perceived Risk (PCR)	0.732

Table 1. The Cronbach alpha result summarized as above.

Model specification: In this model specification the contribution of

each independent variable to the dependent variable is measure.

How well do the predict variable on employee performance? How much variance in employee performance scores can explains by scores on these five variables? Which is the best predictor of Islamic banking service? These questions are answers in this model/ equation/.

The following empirical model will be used to explain the data:

$Y = \beta_0 + \beta_1 \text{ REA} + \beta_2 \text{ CPX} + \beta_3 \text{ AWS} + \beta_4 \text{ CPT} + \beta_5 \text{ PCR} + \epsilon$ was the regression model specification

Where; Y=dependent variable (Islamic banking financial services),

β_0 =Constant,

β_1 – β_5 =Coefficients of the independent variables,

REA=Relative Advantage,

CPX=Complexity,

AWS=Awareness,

CPT=Compatibility,

PCR=Perceived Risk,

E=Error term.

Results and Discussion

This section presents the analysis, discussion and inferences made on the basis of the responses obtained. All the data were coded and entered in to SPSS version 20.0 and inferences were made based on the statistical results. The research instrument used in the study was survey questionnaire. The location of the study was Harar town. The study population comprised the commercial banks' interest free window employees and customers.

Inferential statistics

This study applied Pearson correlation analysis and multiple regression analysis to analyze the relationship between the study variables. The study findings are described in the following subsections (Table 2).

Correlation analysis

		IBFS	REA	CPX	AWS	CPT	PCR
Islamic banking financial services (IBFS)	Pearson correlation	1					
	Sig. (2-tailed)						
Relative Advantage (REA)	Pearson correlation	.256**	1				
	Sig. (2-tailed)	.000					
Complexity (CPX)	Pearson correlation	.242**	.108*	1			
	Sig. (2-tailed)	.000	0.032				
Awareness (AWS)	Pearson correlation	.269**	-0.012	.727**	1		
	Sig. (2-tailed)	.000	0.437	.000			
Compatibility (CPT)	Pearson correlation	-0.162	-.129*	-.729**	-.728**	1	
	Sig. (2-tailed)	0.023	0.019	.000	.000		
Perceived Risk (PCR)	Pearson correlation	.123*	0.068	-0.063	0.034	-0.008	1
	Sig. (2-tailed)	-0.025	0.267	0.415	0.379	0.464	
	N	178	178	178	178	178	178

** . Correlation is significant at the 0.01 level (2-tailed).

* . Correlation is significant at the 0.05 level (2-tailed).

Table 2. Correlation matrix.

The above table shown that, the correlation coefficient value described as all independent variables that are relative advantage, complexity, awareness, compatibility and perceived risk have small positive relationship and statistically significant correlation with dependent variable that is Islamic banking financial service.

Regression analysis: The regression analysis was conducted to know by how much the independent variable explains the dependent variable. Regression model result for beta coefficients. Regression model result for beta coefficients (Tables 3 and 4).

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig
	B	Std. Error			
1 (Constant)	-0.571	0.163		-4.561	.0

REA	0.279	0.078	0.14	2.643	0.008
CPX	0.317	0.083	0.199	2.874	0.002
AWS	0.578	0.106	0.537	5.368	0.001
CPT	0.292	0.058	0.181	3.323	0.001
PCR	0.548	0.142	0.451	5.432	0

Dependent variable: IBFS

Table 3. Regression model result for beta coefficients.

$Y = \beta_0 + \beta_1 \text{ REA} + \beta_2 \text{ CPX} + \beta_3 \text{ AWS} + \beta_4 \text{ CPT} + \beta_5 \text{ PCR} + \epsilon$ was the regression model specification

Where; Y=dependent variable (Islamic banking financial services),

β_0 =Constant,

β_1 – β_5 =Coefficients of the independent variables,

REA=relative advantage,

CPX=complexity,

AWS=awareness,

CPT=compatibility,

PCR=perceived risk

ϵ =Error term.

Based on the regression analysis results shown in the table the regression model became;

$$Y = -0.571 + 0.279 \text{ REA} + 0.317 \text{ CPX} + 0.578 \text{ AWS} + 0.292 \text{ CPT} + 0.548 \text{ PCR}$$

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	62.238	5	19.596	197.562	0
Residual	5.127	51	0.101		
Total	67.365	56			

Dependent variable: IBFS;

Predictors: (Constant) REA: Relative Advantage; CPX: Complexity; AWS: Awareness; CPT: Compatibility; PCR: Perceived Risk

Table 4. ANOVA and R square.

The results indicated that the model is statistically significant in showing how relative advantage, complexity, awareness, compatibility and perceived risk affect the Islamic banking financial services in study area.

Summary of hypotheses testing: In this study Linear Regression was used to test the research hypotheses (Table 5).

Factors	Beta	T-Values	Sig.	Mean	Std. dev	Decision hypothesis	on
REA	0.279	4.179	.000**	3.653	0.83619	Accept H ₁	
CPX	0.317	4.389	.000**	4.356	0.36597	Accept H ₂	
AWS	0.578	2.638	.000**	4.455	0.46459	Accept H ₃	
CPT	0.292	4.389	.000**	1.769	0.32317	Accept H ₄	
PCR	-0.548	2.96	.000**	2.132	0.53287	Accept H ₅	

*. Statistically significant at the 0.01 level

Table 5. Regression coefficients result.

The above table shown that, the p-value (0.000) of all variables is found to have a significant effect on Islamic banking financial services at 1% significance level. Therefore, all null hypotheses are accepted. Specifically, the Perceived relative advantage of using Interest free banking positively affects Islamic banking financial services. The mean of variable is 3.653 which show that as the respondents perceived that getting financial services via separate windows is

proper activity, they deal with than conventional one and beneficial as financing is based on shares profit or loss made out of it than conventional one. In the same way, the complexity of an invention affects how well customers view it and develops a certain attitude. The result shows as complexity negatively influences Islamic banking financial services. The mean of the variables is 4.356 which indicates as understanding and using terms and concepts of Interest free banking do not requires a lot of mental effort, and the different name

the banks use for these financial from the conventional simple to understand and use.

Also, the customers' Awareness has positive and significant effect. The mean of variable is 4.455 which indicate as customers do not properly know the current service offered by the bank.

Similarly, the perceived compatibility of using interest free banking positively significantly affects Islamic banking financial services. The mean of the variable is 1.769 which indicate as respondents perceived that the products and services provided via separate windows can fit with their banking needs than conventional as it depends on sharia, and good complementary product that fulfill their belief and ways of life.

Further, risk of using Interest free banking negatively and significantly affects the attitude of customers towards Islamic banking financial services. The mean value of variables is 2.132 which indicate the customers are not clear and trust the bank regarding IFB transaction.

Conclusion

Based on the findings obtained the following conclusions are drawn:

- Islamic banks' Interest free financial services are not properly used by the customers as the result of less perceived relative advantage of owing it by the customers.
- Islamic banks' Interest free financial services are not properly used because of low level of customers awareness towards the existence of the interest free financial services.
- Islamic banks' Interest free financial services are not properly used because of the perceived complexity of Interest free financial services provided to the customers.
- Islamic banks' Interest free financial services are not properly used because; using Interest free financial products and services is not compatible from customers' points of view.
- Islamic banks' Interest free financial services are not properly used because of less Perceived Trust of customers on the banks.

Recommendations

Based on the conclusions drawn the following recommendations are forwarded:

- The bank should prepare different awareness creation programs and advertisement packages to create good awareness regarding Islamic banks operation and their services through focusing and continuing the Awareness creation programs using different occasions.
- The bank should have to make adjustment on the media used on their marketing and promotion strategy to create customers awareness on business transaction and a concept of profit and loss sharing practice.
- The bank should improve customers understanding regarding the benefit they will get if they use the services.
- The bank should design services according to customers' preference.
- To avoid the probability of complexity, transparency should practice in transaction with customers and full compliance of product with Sharia practice.

Reference

1. Brown TA. Confirmatory factor analysis for applied research. Guilford publications. New York. (2015).
2. Creswell J. Qualitative inquiry and research design: Five different approaches. Thousand Oaks, CA: Sage Publishing, Canada, (2013).
3. Rosly S and Bakar M. Performance of Islamic and mainstream banks in Malaysia. *Int J Soc Econ* 30 (2003a): 1249-1265
4. Saidi A. Relationships between ethical and Islamic banking systems and its business management implications. *South African J Bus Manag* 1 (2007): 43-49.
5. Ayub M. Understanding Islamic Finance. John Wiley and Sons Ltd. England, (2007).
6. Aliyu SUR. Islamic banking and finance in Nigeria: issues, challenges and opportunities. (2012).
7. Arts JWC, Frambach RT and Bijmolt THA. Generalizations on consumer innovation adoption: A meta-analysis on drivers of intention and behavior. *Int J Res Mark* 28 (2011): 134-144.
8. Brown I, Cajee Z, Davies D and Stroebel S. Cell Phone Banking: Predictors of Adoption in South Africa: An Exploratory Study. *Int J Inf Manage* 23 (2003): 381-94.
9. Burch TK. Demography in a new key: a theory of population theory. *Demographic Res* 9 (2003): 263-284.
10. Cronbach LJ and Meehl PE. Construct Validity in Psychological Tests. *Psychol Bull* 52 (1955): 281-302.
11. Mohammed M. Islamic banking: Prospects, opportunities and challenges in Ethiopia. An MBA Thesis submitted to Addis Ababa University, Department of Accounting and Finance, (2012).
12. Mulder M. Customer Satisfaction with Training Programs. *J Eur Ind Train* 25 (2001): 321-331.
13. Tahir IM, Bakar N, Ismail M and Wan W, et al. Customer expectations and perceptions of service quality in Islamic banking: Evidence from Malaysia. *J Islam Econ Finan Bank* 2 (2006): 70-82
14. Tan M and Teo TSH. Factors Affecting the Adoption of Internet Banking. *J Assoc Inf Sci* 1(2000).
15. Taylor S and Todd PA. Understanding information technology usage: A test of competing models. *Inf Syst Res* 6 (1995): 144-176.
16. Teferi M. Contribution of IFB to economic development and its prospect in Ethiopia. An MBA Thesis submitted to Addis Ababa University, Department of Management, (2015).
17. Iqbal M. Challenges Facing Islamic Banks, Islamic Research and training Institute, Occasional Paper -1. (1998).
18. Kahf M and Khan T. Principles of Islamic Finance. Jeddah: Islamic Research and Training Institute-Islamic Development Bank, (2007).
19. Karbhari Y, Naser K and Shahin Z. Problems and challenges facing the Islamic banking system in the west: The case of the UK. *Thunderbird Int Bus Rev* 46 (2004): 521-543.
20. Kettell B. Introduction to Islamic Banking and Finance. Wiley Finance publisher, United Kindom, (2011).

21. Tsion and Sisay. Challenges and opportunities of interest free banking in Ethiopia. Department of Accounting and Finance, (2017).
22. Yewubedar and Getachew. Assessment of prospects and challenges of interest free banking in Ethiopia in the case of commercial bank of Ethiopia. St. Mary's University publisher, Nova Scotia, Canada, (2018).
23. Debebe and Alemu. Factors Affecting Customers' to Use Interest Free Banking in Ethiopia. AAU Institutional Repository, (2015).
24. Hanudin Amin. Some Viewpoints of Islamic Banking Retail Deposit Products in Malaysia. Lecturer, University Malaysia Sabah. Sabah, Malaysia, (2013).
25. Ismaeil. Conventional bank and Islamic bank as institutions: similarity and difference. university of Kebangsaan Malaysia. Selangor, Malaysia, (2015).
26. Kerima, Ali. Challenges on Interest Free Banking Services: The Case of Commercial Bank of Ethiopia. AAU Institutional Repository, (2016).
27. Nobel, Demissie. Factors affecting the implementation of interest free banking service in Ethiopia: the mediation role of customer involvement. Thesis submitted to Addis Ababa university college of business and economics department of MBA, (2019)

How to cite this article: Edilawit, Gebregiorgies. "Factors Affecting Islamic Banking Financial Services In Ethiopian Banking Industry; In The Case of Commercial Bank of Ethiopia." *J Account Mark* 11 (2022): 386.